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Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-754

LOCAL 705, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, AND LOUIS F. PEICK,
Petitioners,

vs.

JOHN DANIEL,
Respondent.

BRIEF FOR PETITIONERS.

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TABLE OF CONTENTS.

PAGE

Opinions Below 1

Jurisdiction 2

Questions Presented 2

Statutes Involved 3

Statement of the Case 6

A. The Creation of the Local 705 International Brotherhood of Teamsters Pension Trust Fund and the Design and Funding of the Pension Plan 6

B. Respondent's Participation in the Local 705 Pension Fund 10

C. The Proceedings in the District Court 11

D. The Proceedings in the Court of Appeals 14

Summary of Argument 20

Argument 23

I. The Relationship Between the Local 705 Pension Fund and a Participant Is Not in Economic Reality an Investment Contract 23

A. The Court Below Relied on the Literal Approach to the Statutes and Misapplied This Court's Decisions Concerning Variable Annuity Contracts .. 23

B. Collectively Bargained Welfare Funds Have Been Discretely Regulated by Congress in the Labor Statutes and the Commission Acknowledged Their Dissimilarities to the Capital Market 27

1. Section 302(c)(5) of the Labor-Management Relations Act of 1947 27

2. The Welfare and Pension Plans Disclosure Act Eschewed Substantive Regulation of Welfare Funds After Congress Had Heard the Commission's Views on Regulation 29

3. The Employee Retirement Income Security Act of 1974 33

C. The Securities Acts' Legislative History Shows No Intention to Cover the Relationship Between a Participant and a Mandatory Noncontributory Pension Fund 41

1. The Rejected 1934 Amendment to § 4(1) of the 1933 Act..... 42

2. The 1941 Rejected Amendment..... 43

3. The Investment Companies Amendment of 1970 43

D. The *Howey* Criteria Are Not Applicable to the Local 705 Pension Fund..... 44

1. Employer Contributions to a Noncontributory Pension Trust Are Not the Employee's Money Which He or She Invests..... 44

2. Profits and Profit Motivation Are Missing in the Pension Transaction..... 52

3. A Participant Has No Shares or Other Evidence of an Interest in the Local 705 Pension Fund Assets..... 54

II. There Was No Sale by the Local 705 Pension Fund to or Purchase by Respondent 55

III. There Is No Implied Private Cause of Action for Violation of Section 17(a) of the Securities Act of 1933 58

Conclusion 63

Appendix A1-A31

AUTHORITIES CITED.

Cases.

Alabama Power Co. v. Davis, 431 U. S. 581 (1977)..48, 49, 50

Allis-Chalmers Corp., 1972-73 Cas. Fed. Sec. L. Rep. (CCH) ¶ 78,803 (1972)..... 55

Arroyo v. United States, 359 U. S. 419 (1959)..... 28

Assalone v. Carey, 473 F. 2d 199 (D. C. Cir. 1972)... 47

Bartmess v. Drewrys, 444 F. 2d 1186 (7th Cir. 1971) ... 49

Blackwell v. Bentsen, 203 F. 2d 690 (5th Cir. 1953), *cert. denied*, 347 U. S. 929 (1954) 62

Blue Chip Stamps v. Manor Drug Stores, 421 U. S. 723 (1975) 54, 59, 62

Buffalo Forge Co. v. Steelworkers Union, 428 U. S. 397 (1976) 52

Chemehuevi Tribe v. FPC, 420 U. S. 395 (1975) 57

Chemical Workers Union v. Pittsburgh Plate Glass Co., 404 U. S. 157 (1971) 49

Collins v. Rukin, 342 F. Supp. 1282 (Mass. 1972) 55

Commissioner v. Produce Reporter Co., 207 F. 2d 586 (7th Cir. 1953) 27

Craig v. Bemis Co., 517 F. 2d 677 (5th Cir. 1975) 25

Emporium Capwell Co. v. Western Addition Community Organization, 420 U. S. 50 (1975) 50

Globus v. Law Research Service, Inc., 418 F. 2d 1276 (2nd Cir. 1969), *cert. denied*, 397 U. S. 913 (1970) .. 61

Greater Iowa Corp. v. McLendon, 378 F. 2d 783 (8th Cir. 1967) 58

Guinzy v. Curtice Burns, Inc., 28 Ill. App. 3d 398, 327 N. E. 2d 284 (1975) 25

Gunter v. Hutcheson, 433 F. Supp. 42 (N. D. Ga. 1977) 59

Hector v. Wiens, 533 F. 2d 429 (9th Cir. 1976) 55

Hines v. Anchor Motor Freight Lines, Inc., 424 U. S. 554 (1976) 50

H. K. Porter Co. v. NLRB, 397 U. S. 99 (1970) 50

Houchens Market v. NLRB, 375 F. 2d 208 (6 Cir. 1967) 57

Hurn v. Plumbing Retirement Fund, 434 F. Supp. 80 (C. D. C. A. 1976) 18, 25

Inland Steel Co. v. NLRB, 170 F. 2d 247 (7th Cir. 1948), *aff'd on other grounds sub nom.* Communications Workers Union v. Douds, 339 U. S. 382 (1950) 49, 52

Joint Industry Board v. United States, 391 U. S. 224 (1968) 47

Keene Corp., 1971-72 Cas. Fed. Sec. L. Rep. (CCH) ¶ 78,475 (1971) 55

Klamberg v. Roth, 425 F. Supp. 440 (S. D. N. Y. 1976) 47

Lawrence v. SEC, 398 F. 2d 276 (1st Cir. 1968) 55

Lewis v. Benedict Coal Corp., 361 U. S. 459 (1960) . . . 47, 48

Lewis v. Quality Coal Corp., 243 F. 2d 769 (7th Cir. 1957) 47, 50

Los Angeles Dept. of Water & Power v. Manhart, ... U. S. ..... (1977) 25, 41

Lugo v. Employees Retirement Fund, 529 F. 2d 251 (2nd Cir. 1976), *cert. denied,* 429 U. S. 826 (1976) 34

Malone v. White Motor Corp., ... U. S. ....., 55 L. Ed. 2d 443 (1978) 29, 31

Massachusetts Financial Services, Inc. v. SIPC, 545 F. 2d 754 (1st Cir. 1976), *cert. denied,* 431 U. S. 904 (1977) 45

Miniard v. Lewis, 387 F. 2d 864 (D. C. Cir. 1967) 50

Missouri Research Laboratories, Inc., 1972-73 Cas. Fed. Sec. L. Rep. (CCH) ¶ 79,036 (1972) 55

Morgan v. Laborers Pension Trust Fund, 433 F. Supp. 518 (N. D. C. A. 1977) 50

NLRB v. Allis-Chalmers Mfg. Co., 388 U. S. 175 (1967) 50, 58

NLRB v. Carpenters Local 1913, 531 F. 2d 424 (9th Cir. 1976) 50

Oklahoma Nat. Gas Co., 1971-72 Cas. Fed. Sec. L. Rep. (CCH) ¶ 78,583 (1971) 55

Pete v. Mineworkers Union, 517 F. 2d 1275 (D. C. Cir. 1976) 56

Piper v. Chris-Craft Industries, 430 U. S. 1 (1977) 57

Robinson v. Mineworkers Health & Retirement Fund, 435 F. Supp. 245 (D. C. 1977) 18, 25

Santa Fe Industries, Inc. v. Green, 430 U. S. 462 (1977) 57

Schaeffer v. First National Bank of Lincolnwood, 509 F. 2d 1287 (7th Cir. 1975)..... 58

SEC v. Addison, 194 F. Supp. 709 (N. D. Tex. 1961).. 55

SEC v. Harwyn Industries, 326 F. Supp. 943 (S. D. N. Y. 1971) 56

SEC v. New England Electric System, 384 U. S. 176 (1966) 57

SEC v. Texas Gulf Sulphur Co., 401 F. 2d 833 (2nd Cir. 1968) 61

SEC v. United Benefit Life Ins. Co., 387 U. S. 202 (1967) 23, 24, 25

SEC v. Variable Annuity Life Ins. Co., 359 U. S. 65 (1959) 23, 25

SEC v. W. J. Howey Co., 328 U. S. 293 (1946) ...15, 44, 54

Sheet Metal Workers Union, 234 NLRB No. 162 (1978) 50

Sheet Metal Workers Local 5 v. Mahoning & Trumbull Bldg. Trades Welfare Fund, 541 F. 2d 636 (6th Cir. 1976) 25

Shull v. Dain, Kalman & Quail, Inc., 561 F. 2d 152 (8th Cir. 1977), *cert. denied,* ..... U. S. ....., 46 USLW 3527 (Feb. 21, 1978)..... 58

Simmons v. Wolfson, 428 F. 2d 455 (6th Cir. 1970), *cert. denied,* 400 U. S. 999 (1971)..... 59

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Surovitz v. Hilton Hotels Corp., 342 F. 2d 596 (7th Cir. 1965), *reversed on other grounds*, 383 U. S. 363 (1966) 58

United Housing Foundation v. Forman, 421 U. S. 837 (1975) 15, 23, 26, 54, 57

United Marine Div. v. Essex Transportation Co., 216 F. 2d 410 (3rd Cir. 1954) 50

United States v. Embassy Restaurant, 359 U. S. 29 (1959) 47

United States v. Enmons, 410 U. S. 396 (1973) 41

United States v. Nat. Ass'n. of Securities Dealers, 442 U. S. 694 (1975) 57

Wiens v. Teamsters Union, BNA Sec. Reg. and L. Rep. No. 397 (C. D. C. A. 1977) 18, 25

Statutes and Regulations.

Employee Retirement Income Security Act of 1974,
29 USC §§ 1001 *et seq.* 16
Section 2, 29 USC § 1001 34
Section 3, 29 USC § 1002 53
Section 102, 29 USC § 1002 ..... 17, 39
Sections 201-211, 29 USC §§ 1051-1061 35
Sections 404-407, 29 USC §§ 1104-1107 39
Section 409, 29 USC § 1109 39
Section 502, 29 USC § 1132 ..... 35, 39
Section 504, 29 USC § 1134 39
Section 514, 29 USC § 1144 ..... 17, 40

Internal Revenue Code of 1939, 53 Stat. 1,
Section 165 ..... 27, 28

Internal Revenue Code of 1954,
Section 401(a) 27

Labor-Management Reporting and Disclosure Act of 1959,
29 USC §§ 401 *et seq.* 58

Labor-Management Relations Act of 1947,
Section 203(d), 29 USC § 173(d) 52
Section 204, 29 USC § 174 52
Section 302, 29 USC § 186 28
Section 302(c)(5), 29 USC § 186(c)(5) .....
.....18, 28-29, 50-51, 52
Section 302(d), 29 USC § 186(d) 39
National Labor Relations Act, 29 USC §§ 151 *et seq.*
Section 8(a)(5), 29 USC § 158(a)(5).....49, 51
Section 8(b)(3), 29 USC § 158(b)(3) 49
Section 9(a), 29 USC § 159(a).....49, 51
Revenue Act of 1928, 48 Stat. 795 § 165..... 42
Securities Act of 1933, 15 USC §§ 77(a) *et seq.*
Section 2(1), 15 USC § 77b(1) 3
Section 2(3), 15 USC § 77b(3) 3
Section 2(10), 15 USC § 77b(10) 59
Section 11, 15 USC § 77k.....59-61
Section 12, 15 USC § 771 60
Section 13, 15 USC § 77m..... 60
Section 17(a), 15 USC § 77q..... 3-4
Securities and Exchange Act of 1934, 15 USC §§ 78a *et seq.*
Section 3(a)(10), 15 USC § 78c(a)(10)..... 4
Section 10(b), 15 USC § 78j(b)..... 4-5
Securities Investor Protection Act of 1970, 15 USC
§§ 78aaa *et seq.* 45
Section 6(c)(2)(A)(ii), 15 USC § 78fff(c)(2)
(A)(ii) 45, 46
Welfare and Pension Plans Disclosure Act, 72 Stat. 997,
76 Stat. 35 .....20, 29-33
Section 10(b) 40
17 C. F. R. 240.10(b)-5.....5, *passim*
Treas. Reg. 1.411(b)-1(a)(1)..... 53

Miscellaneous.

American Council of Life Insurance, Pension Facts 1976 41
Briefs for the Securities and Exchange Commission..... 62
73 Cong. Rec.
8708 (1934) 42
10181-82 42
104 Cong. Rec. (1958)
7049 .....29, 30
7053 29
7056 31
7062 30
7231 29
7492 31
7493 31
108 Cong. Rec. (1962)
1732 32
1738 32
1924 .....29, 32
1932 32
1933 33
114 Cong. Rec. 23051, 23052 (1968)..... 43
Douglas & Bates, The Federal Securities Act of 1933, 43 Yale L. J. 171 (1933)..... 61
Fed. R. Civ. P. 23(b)(2)..... 11
Grubbs, Report to the Secretary of Labor, Potential Effects of *Daniel* 36, 37
Hearings on S. 1122 et al. Before the Senate Subcomm. on Welfare and Pension Plan Legislation of the Senate Comm. on Labor and Public Welfare, 85th Cong., 1st Sess. (1957) 30, 31, 32

Hearings before the House Comm. on Interstate and Foreign Commerce, 77th Cong., 1st Sess. (1941) . . . 41, 43, 62

H. R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 60

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H. R. Rep. No. 1280, 93d Cong., 2d Sess. (1974) 35

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Legislative History of the Employee Retirement Income Security Act of 1974 . . . . . 35, 39

Legislative History of the Labor-Management Relations Act of 1947 . . . . . 28, 29

Loss, Securities Regulation (2d ed. 1961) 61

Note, 70 Harv. L. Rev. 490 (1957) 57

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Securities and Exchange Commission Institutional Investor Study (1971) 56

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S. Rep. No. 1734, 84th Cong., 2d Sess. (1956) 29

S. Rep. No. 1440, 85th Cong., 2d Sess. (1958) 29, 30, 31

S. Rep. No. 91-184, 91st Cong., 1st Sess. (1969) 43

S. Rep. No. 92-634, 92d Cong., 2d Sess. (1972) 40

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LOCAL 705, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, AND LOUIS F. PEICK,

Petitioners,

vs.

JOHN DANIEL,

Respondent.

BRIEF FOR PETITIONERS.

OPINIONS BELOW.

The opinion of the United States Court of Appeals for the Seventh Circuit appears at 561 F. 2d 1223 and is contained in a separate appendix (App.) at 209a-262a. The opinion of the United States District Court for the Northern District of Illinois, Eastern Division, appears at 410 F. Supp. 541 and in the appendix at 106a-134a.

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 3(a)(10) of the Securities and Exchange Act of 1934 provides:

When used in this chapter, unless the context otherwise requires—

* * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Section 10(b) of the Securities and Exchange Act of 1934 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE.

This is a civil class action by a former participant against his pension fund seeking damages and injunctive relief for the plan's alleged diversion of funds and material misrepresentations and omissions in violation of the antifraud provisions of the federal securities acts, a federal labor statute, and state common law.

A. The Creation of the Local 705 International Brotherhood of Teamsters Pension Trust Fund and the Design and Funding of the Pension Plan.

In 1954 petitioner Local 705, International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America (Local 705) and several multiemployer bargaining associations representing trucking employers domiciled in the Chicago, Illinois, area negotiated a collective bargaining agreement requiring each signator employer to contribute, effective January 1, 1955, "the sum of 5 cents for each hour of employment by each employee into a trust fund for the purpose of providing pension benefits to employees covered by this agreement." The trust agreement signed by these parties created the Local 705 International Brotherhood of Teamsters Pension Trust Fund (Local 705 Pension Fund)[1] and vested in the board of trustees composed equally of employee and employer representatives exclusive and plenary authority to manage the trust and to formulate and administer a pension plan.[2] The trust agreement disclaimed

1. App. 62a, Trust Agreement, Art. 4, § 18. The Local 705 Pension Fund was established and is administered separate from any other pension fund, local union (except Local 705) or the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America. App. 53a, ¶ 2; 59a, ¶¶ 9-11.

2. The trust agreement (App. 62a) provided that the trustees had sole authority, e.g., to supervise and conduct the trust's business,

(Footnote continued on next page.)

an intention to grant an employee any interest in the fund or its assets unless and until he or she became eligible for the receipt of benefits, i.e., vested.[3] The trustees consulted an actuary to design a pension plan.[4]

The trustees decided that they wished to help finance the later

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(Footnote continued from preceding page.)

Art. 4, §§ 1 and 2; to collect, invest and deposit the employers' contributions, Art. 3, Art. 4, §§ 3, 4; to make final and binding decisions on "[a]ll questions or controversies," Art. 5, § 2; to formulate a pension plan, Art. 7, §§ 1 and 2, Art. 12; to promulgate rules and regulations, Art. 4, § 11; "to construe the provisions of" the trust agreement and "the terms and regulations of the pension plan," Art. 4, § 18; to amend the trust agreement, Art. 10; and to terminate the trust, Art. 11.

3. **ARTICLE 13**

Vesting of Rights

> **Section 1.** No employee, or other person shall have any vested interest or right in the Trust Fund or in any payments from the Trust Fund; provided, however, the rights of any person who has become eligible for benefits hereunder by fully meeting the requirements of this Trust Agreement shall not be affected, changed, or altered by any amendment to this Trust Agreement, unless the Trust Fund, in the opinion of the Trustees, is inadequate to meet the payments due, in which event the Trustees shall determine whether such benefits shall be reduced or the Trust terminated.

* * * * *

ARTICLE 14

Miscellaneous.

> **Section 1.** * * * No employee shall have any individual right, title, or interest, or claim against any Employer, Employer's contribution, or the Trust Fund, except as may be expressly provided for in this Agreement.

App. 62a.

4. App. 169a (Affidavit of A. S. Hansen, Inc.). The Hansen affidavit was an exhibit to petitioners' opposition to class certification and not before the district court when it denied petitioners' motion to dismiss. However, it was considered by the parties and the court of appeals (App. 238a n.35, 258a n.61). Appended to this brief (A1-A31 *infra*) is the May 1978 affidavit of A. S. Hansen, Inc. which updates the fund statistics through the 1977 plan year and whose basic purpose is discussed *infra* at 36-38.

years of present employees who had already given long service to the employers. Accordingly, years of service before January 1, 1955 were to be counted as credited service for vesting purposes (past service). It was therefore necessary to set aside sufficient monies from the weekly employer contributions to take care of that pre-plan service (unfunded past service cost). Because, as we shall see, that decision saddled the fund with a large unfunded past service cost, and because the weekly contribution rate was only $2.00, the trust agreement and plan were written to properly fund the plan.

The employers were required to make the full weekly contribution for each employee on the seniority roster without regard to the hours or days worked. Thus $2.00 per week was paid into the fund for time when the employee performed no work—such as unexcused absences; lack of work during the week after the employee had started the week; for six months in the case of absence due to an occupational illness or injury and four weeks for nonoccupational; and during a leave of absence. Conversely, no additional contributions were paid for daily or weekly overtime work or other premium work such as Saturday, Sunday or a contractually designated holiday (App. 62a, Trust Agreement, Art. 3, § 1).

The plan began with a single defined benefit: a lifetime pension of $75 per month known as the normal retirement pension. In order to pay for the pension, based on the actuarial assumptions, its receipt was conditioned on the employee meeting four requirements: (1) Attainment of normal retirement age (65). (2) Employment with a contributing employer (covered employment) for twenty continuous, consecutive and uninterrupted years (the service rule). (3) Retirement from covered employment. (4) Application to the trustees (App. 54a, ¶ 4; 68a, 1958 Plan, Rule 1).

In the first year of the plan forty-seven employees who were at least age 65 and whose past service met the service rule retired and began receiving $75 per month (App. 175a). The maximum

total contributions received for the retirees—assuming that they all retired on December 31, 1955, which was not the case—was $104 per retiree or $4,888. However, the plan incurred an unfunded past service cost of $8,394 per retiree or $394,518 for the group as the actuarial value of the normal retirement pensions (App. 175a, 177a).

The plan rules and benefits were incorporated into booklets and mailed to participants in 1958, 1969 and 1973 (App. 63a, 70a, 72a). Changes in the published provisions were communicated to the participants by letter and at union meetings (App. 189a-192a). The trust agreement, pension plan and all amendments received favorable determination letters that the trust and plan qualified under § 401(a) of the Internal Revenue Code of 1954 (App. 55a, ¶¶ 5, 6; 74a).

Over the years Local 705 and the employers negotiated increases in the weekly contribution rate (App. 192a). The trustees used the additional contributions to create new pension benefits (disability, vested and reciprocal), to increase the amounts of the pensions, to extend coverage to a spouse and dependent children, and to lower the normal retirement age to 57 (App. 193a). To keep pace with rising living costs the $75/month retirees were raised to $100 in 1960, to $150 in 1965, and to $250 in 1969 (App. 193a). As of the end of the 1976 plan year a participant who had met the service rule (as modified by the Employee Retirement Income Security Act of 1974 effective for the plan year beginning February 1, 1976) could elect the following lifetime pensions with survivor privileges:

Age	Monthly Benefit
57-59	$425
60-64	$525
65	$550

(A12 *infra*). Each improvement created an unfunded liability for all service performed to the date of the change (A14 *infra*).

On January 31, 1977 the fund assets were $122.5 million (A5 *infra*). There were 16,003 active participants in the plan of whom 6,690 had vested nonforfeitable rights but had not yet retired (A8, A9 *infra*). There were also 3,117 receiving benefits—one retiree for every five active participants—which amounted to approximately $12.3 million for the plan year. Nearly $110.2 million of the fund's $122.5 million of assets is necessary to fund the actuarial value of these beneficiaries' pensions. An additional $122.3 million will be required for benefits accrued to date for the vested active participants; this will require an additional $110 million from future employer contributions. At the end of the plan year nearly 51% of all covered employees and retirees had a nonforfeitable right to pension benefits (A9 *infra*).

B. Respondent's Participation in the Local 705 Pension Fund.

Respondent entered covered employment in April 1950 and therefore received five years of past service credits. On December 5, 1960, having accrued over ten years toward the service rule, respondent was laid off. He returned to covered employment on July 5, 1961. Prior to the layoff respondent had received a copy of the plan booklet (Pl. Dep. 107). The 1958 plan booklet stated that the weekly contributions must be paid by the employer or by the employee when, e.g., the employer was no longer obligated to do so (App. 68a, 1958 Plan Booklet, p. 2; Rule 1, p. 6; see also p. 4, ¶¶ 1, 2). It warned that "[y]our benefits terminate the day that you take the withdrawal card" (App. 68a, p. 4, ¶ 3). Respondent took a withdrawal card (App. 59a; Pl. Dep. 107). As a result, respondent's accrued service could no longer be counted toward completion of the service rule.

On December 1, 1973 respondent, at age 63, retired from covered employment. About that time respondent asked the Local 705 Pension Fund administrator whether he was eligible

for either a normal retirement ($400) or a vested[5] pension. He was advised that due to the break in service he had twelve years of credits toward the service rule. Respondent appealed to the trustees.[6] On December 26, 1973 respondent appeared before the trustees and "requested that the trustees cure a break in service to make him eligible for pension benefits." The request was denied based on the service rule language in the plan (App. 58a). Upon receipt of the trustees' written decision he requested reconsideration. On March 28, 1974 respondent appeared before the trustees to request a waiver of the service rule; the prior decision was affirmed (App. 58a-59a). A copy of the minutes was sent to respondent. At neither hearing did respondent claim that he had been unaware of the service rule or misled concerning the plan's eligibility requirements.

C. The Proceedings in the District Court.

On October 3, 1974, respondent filed in the United States District Court for the Northern District of Illinois, Eastern Division (the district court), a five count class action complaint against the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America (the International Union) and petitioners.[7] Count I of the complaint was based

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5. A monthly pension of $250 was payable at age 65 for employees who retired after meeting the service rule regardless of age at the time of retirement (App. 72a, 1973 Plan, §§ 2.03, 3.03).

6. Section 5.02(a) of the 1973 Plan (App. 72a) permitted an aggrieved participant-applicant "to appear before the trustees at a meeting to present his case . . . himself or by a representative."

7. Respondent sought a plaintiff class composed of the members of all local unions affiliated with the International Union which local unions were parties to collectively bargained pension plans and the plans' present and former participants. The requested defendant class consisted of all local unions affiliated with the International Union which were parties to collectively bargained pension plans and the trustees of the pension funds. While the case was before the court of appeals (App. 217a n.8), the district court certified a plaintiff class under Fed.R.Civ.P. 23(b)(2) composed of

(Footnote continued on next page.)

on § 10(b) of the Securities and Exchange Act of 1934 (1934 Act), 15 USC § 78j(b), and Rule 10b-5 of the Securities and Exchange Commission (Commission), 17 C. F. R. 240.10(b)-5. It alleged that Local 705 negotiated collective bargaining agreements with employers on behalf of members who agreed to work for the employers "in return for the payment of wages and the receipt of various other forms of consideration" (App. 29a, Complt. ¶ 11). Beginning about 1955 Local 705 and the employers negotiated a pension plan provision in the collective bargaining agreement requiring the employers to make fixed contributions to a pension fund "as part consideration for the labor services provided by such union members," which contributions were held in trust and invested by the trustees. The employees, according to the complaint, "thus contribute their labor services in return for, in part, their participating interest in" the Local 705 Pension Fund (App. 29a, Complt. ¶ 12). It further alleged that the Local 705 Pension Fund plan has "very long and arbitrary vesting periods" which result in the contributions for a nonvested participant being forfeited, thereby rendering worthless "the value of the member's interest" and "his participating interest in any accumulated earnings on all employer contributions made on his behalf" (App. 29a-31a, Complt. ¶¶ 11, 13-15). The complaint then set out respondent's participation in the plan, break in service, and denial of a pension (App. 31a, Complt. ¶ 16).

(Footnote continued from preceding page.)

> all persons (1) who are now, or who were, members of Local 705 . . ., and who have purchased or otherwise acquired an interest in, through a contribution to or on whose behalf a contribution has been made to, the Local 705 Pension Fund, which requires for the payment of a full retirement benefit a total period of service in excess of twenty (20) years.

The district court denied defendant class certification noting that Local 705 and the Local 705 Pension Fund "are the only ones against whom relief can be sought. Class certification is inappropriate since the defendants are no longer 'so numerous that joinder [of all] is impracticable,' Rule 23(a)(1)." We shall therefore discuss the complaint within the framework of the Local 705 Pension Fund and Local 705.

According to the complaint the Local 705 Pension Fund made misrepresentations consisting of misleading statements "as to the length requirements . . . and continuity requirement of the [plan] vesting provisions" (App. 32a) and omissions by not stating material facts that the failure to meet the service rule would result in denial of a pension and forfeiture of the contributions and earnings thereon (App. 32a-33a, Complt. ¶ B(1)-(4)); concerning the "actuarial basis on which [the plan] . . . has been constructed and the actuarial likelihood that a [participant] . . . will receive back as a pension benefit any or all of any employer contributions made on his behalf . . ." (App. 33a, Complt. ¶ B(5)); that the plan's "actuarial basis" is "arbitrary and without any reasonable basis in fact" (App. 33a, Complt. ¶ B(6)); and that "funds have been diverted" and used to the defendants' or others' advantage (App. 33a, Complt. ¶ B(7)). He requested deletion of the offending vesting provisions and damages "equal to all pension benefits unlawfully denied" respondent and class members and "which have been unlawfully diverted . . ." (App. 35a-36a).

Count II incorporated the operative allegations of count I and alleged a violation of § 17 of the Securities Act of 1933 (1933 Act), 15 USC § 77(q) (App. 37a, Complt. ¶ 20). Count III claimed that the conduct alleged in count I breached the duty of fair representation owed by Local 705 to respondent and the class members under § 9(a) of the National Labor Relations Act (NLRA). Count IV was a catch-all claim of state common law fraud which attached only by the doctrine of pendent jurisdiction. Counts V and VI[8] alleged that the trustees had violated their fiduciary duty created by, and the "for the sole and exclusive benefit of the employees" mandate contained in, § 302(c)(5) of the Labor-Management Relations Act of 1947.

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8. Count VI was added as an amendment to the complaint on February 3, 1975.

Petitioners[9] moved to dismiss counts I and II of the amended complaint[10] because the relationship between a participant and the Local 705 Pension Fund does not involve the sale of a security and § 17(a) of the 1933 Act does not create a private cause of action for fraud. After petitioners had briefed the issues (App. 2a), respondent filed an affidavit (App. 6a; C.A. App. 94a) concerning his education, work history and understanding of the service rule and plan communications, ending with his opinion that "[h]ad I known of the way in which Local 705 and the Local 705 Pension Plan Trustees would interpret the eligibility requirements for a retirement benefit, I would have sought employment (and, if necessary, retraining for new employment) elsewhere—with retirement benefits I understood Local 705 to be offering" (C.A. App. 96a, ¶ 7).

On March 1, 1976 the district court entered a memorandum opinion and order denying the motion to dismiss (App. 106a-134a). It overruled motions to vacate the order but certified under 28 USC § 1292(b) the securities acts issues for an interlocutory appeal (App. 162a).

D. The Proceedings in the Court of Appeals.

The United States Court of Appeals for the Seventh Circuit (court of appeals) granted a timely petition to appeal, received briefs from *amici*, and permitted the Secretary of Labor and the Commission to participate in oral argument. On August 20, 1977 the court of appeals filed a fifty-four page opinion affirm-

9. On January 28, 1976, the district court granted respondent leave to again amend the complaint by adding the remaining trustees of the Local 705 Pension Fund as parties defendant and as representative of the Local 705 Pension Fund. These defendants filed a motion to dismiss which is pending before the district court. With the joinder of the trustees, the Local 705 Pension Fund became a defendant below.

10. Because only the securities acts issues are presented to this Court we shall not discuss either the arguments addressed to or the district court's decision sustaining claim jurisdiction for the remaining counts in the amended complaint.

ing the district court's decision and general mode of analysis, relying heavily on respondent's affidavit (App. 213a-15a, 245a, 246a n.41).

The court of appeals found that the relationship between a participant and the Local 705 Pension Fund is a security in the form of an investment contract because, first, the employers' contributions "constitute a sector of the total employee compensation structure" (App. 223a) and therefore "the investment of money prong of the *Howey* rule has been satisfied" (App. 225a). Second, the Local 705 Pension Fund functions as a common enterprise because the employees have an undivided interest in the trust "without . . . having certificates evidencing their interest or the power to transfer their interests in the trust" (App. 225a) or control over the trust fund and investment. Third, the value of the promised pension benefits exceeds the employers' contributions and is derived from the efforts of persons other than the employees; therefore the pension benefits are "profits" within the meaning of *SEC* v. *W. J. Howey Co.*, 328 U. S. 293 (1946), as refined in *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837 (1975).

Turning to a discussion of "[e]conomic reality," the court of appeals said that the Local 705 Pension Fund "resembles a mutual fund" (App. 231a). Respondent's interest therein, which "is also like an interest in a variable annuity contract", is divisible; i.e., "the employment fringe benefits aspect of a pension can be separated from its security aspects" (App. 231a-32a). Because investments made by private pension plans are a significant force in the capital markets and "pension funds are the most efficient way for an employee to invest", if private pension plans are "exempt from the anti-fraud provisions of the securities laws, then policing of the capital markets is significantly neutralized" (App. 232a-33a).

It read legislative history subsequent to the securities acts and "the [Commission's] interpretation of the securities acts" (App.

JURISDICTION.

This Court has jurisdiction under 28 USC § 1254(1). The judgment of the United States Court of Appeals for the Seventh Circuit was entered on August 20, 1977. Mr. Justice Stevens extended the time for filing the petition for a writ of certiorari to November 25, 1977. On February 21, 1978 this Court granted the petition and in No. 77-753 and consolidated the cases.

QUESTIONS PRESENTED.

Does an employee's coverage under an employer funded pension plan, as a compulsory incident of his employment, involve the "sale" of a "security" to the employee and hence a transaction subject to the federal securities laws? If so, can a cause of action be posited on each of the several antifraud provisions of those laws by one who alleges that there were material misrepresentations and failures to disclose in connection with such a "sale"?

STATUTES INVOLVED.

This case involves § 2(1), and (3) and § 17(a) of the Securities Act of 1933, 15 USC § 77(b)(1), (3) and (q); § 3(a)(10) and § 10(b) of the Securities and Exchange Act of 1934, 15 USC § 78c(a)(10) and § 78j(b); Rule 10b-5 of the Securities and Exchange Commission, 17 C. F. R. 240.10(b)-5.

Section 2(1) of the Securities Act of 1933 provides:

> When used in this subchapter, unless the context otherwise requires—
>
> > (1) the term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 2(3) of the Securities Act of 1933 provides as pertinent:

> The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. * * *

Section 17(a) of the Securities Act of 1933 provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> > (1) to employ any device, scheme, or artifice to defraud, or

with the national labor policy were dismissed as "specious" (App. 257a). In the court of appeals' view a union's duty of fair representation and the purposes of § 302(c)(5) of the Labor-Management Relations Act of 1947 are supplemented and the national labor policy enhanced by requiring that employees be furnished pension plan information deemed relevant by a court.

The court of appeals disclaimed an intention to require "the filing of any document or establish judicial control over pension fund operations" (App. 258a). The burden placed upon pension funds by its decision should not be "undue" (App. 258a-59a). While rejecting an intent to apply the registration provisions to subject pension funds, the court below left that issue in a state of uncertainty. Also left to future litigation were "any possible obligations of employers under the 1933 and 1934 acts with regard to pension plans" (App. 258a n.61).

The court below rejected three cases which are contrary to its decision, *Hurn* v. *Plumbing Retirement Fund,* 434 F. Supp 80 (CD CA 1976); *Wiens* v. *Teamsters Union,* BNA Sec. Reg. and L. Rep. No. 397 at A-13 (CD CA 1977); *Robinson* v. *Mineworkers Health & Retirement Fund,* 435 F. Supp. 245 (DC 1977) (App. 228a-29a, 247a n.43).

Judge Tone, led by "certain doubts", wrote separately that "this is a close and difficult case" and "I am beset by the same doubts arising from the ordinary meaning of the words 'security,' 'investment contract,' and 'sale' and from Congress' basic purpose in adopting the Securities Acts that must have influenced the several district judges who have reached conclusions inconsistent with ours". The relationship between respondent and the Local 705 Pension Fund "do[es] not fit neatly into the traditional concept of a sale of a security". "[I]t may well be" that this Court's recent decisions, including *Forman,* "indicate 'a pronounced disfavor with attempts to stretch the securities laws beyond their traditional scope' " (App. 260a).

Judge Tone found the Commission's "former position" to apply to the antifraud provisions and that Congress in post-

securities acts legislation "must have understood that they [the securities acts] did not apply to transactions of the kind before us" (App. 261a). Nevertheless, the breadth of the securities acts' definitions (App. 260a), Congress' understanding "that the [Commission] is not infallible", and that the applicability of the securities acts to mandatory noncontributory pension plans "has yet to be determined by the Supreme Court," led Judge Tone to conclude that "Congress has chosen to leave the matter in that posture" (App. 261a-62a).

SUMMARY OF ARGUMENT.

This is the first reported case to decide that the relationship between a mandatory noncontributory pension plan and a participant is the sale of a security which thereby allows the participant to sue the plan under the securities acts' antifraud provisions and rule 10b-5 for alleged material misrepresentations and omissions concerning the plan's vesting requirements. The absence of previous litigation itself brings into question the soundness of the decision below.

The court below took a literal approach to the securities acts' definitional sections rather than applying economic reality to the underlying transaction as instructed by this Court. In the few pages nominally devoted to the economic realities test, and proceeding from the fiction that a nonvested participant has an undivided interest in a mandatory noncontributory defined benefit plan and a misreading of two decisions of this Court, the court of appeals analogized the plan to a mutual fund and to the issuer of a variable annuity contract. In reality, the Local 705 Pension Fund, because it gives the participant no interest in the fund and promises only a fixed benefit lifetime annuity, is unlike a mutual fund or the issuer of a variable annuity contract which promises financial growth pegged to the offeror's acumen in the capital market.

The economic realities of collectively bargained pension funds are best viewed from Congress' perspective of these plans as a form of private social security to be discretely regulated by the labor statutes—§ 302 of the Labor-Management Relations Act of 1947, the Welfare and Pension Plans Disclosure Act and ERISA. The legislative histories of these statutes show that Congress and the Commission viewed collectively bargained plans as being outside of the securities acts' milieu—a position which the Commission renounced in the court below—and ex-

plain the absence of demonstrable congressional intent to place these plans' noninvestment functions under the securities acts, antifraud provisions. An analysis of the securities acts and their legislative histories lends no support to the court of appeals' expansive reading of "security" and "sale".

As a matter of economic reality, the participant-plan relationship does not create an investment contract basically because a participant does not invest his or her money in, is not led to expect profits from, and has no shares in the Local 705 Pension Fund evidenced by formal certificates or by nominal interests in the fund assets. The employer contributions cannot be equated with deferred wages or compensation over which the employee has dominion; to do so is to misconceive the nature of a pension plan and to do violence to the national labor policy which commits the subject of pension plans to the majority representative. The inchoate pension benefit cannot be conceived of as traditional profits simply because the expected payment may exceed the employer contributions made on "behalf" of the employee.

The elements of a sale are missing because, in addition to the matters discussed in reference to a security, the employee has no volition whether to enter or continue in the plan, and volition is a critical element of a sale. The nature of the collective bargaining process extinguishes individual volition in favor of majority rule and representation; therefore employee volition cannot be manufactured from the random happenstance of the employee voting on the negotiated collective bargaining agreement or the inapt analogy to the rights of a minority shareholder. Until its brief in the court below, the Commission—to the knowledge of the parties, the district court and one judge below—said that no sale occurred in the case of a plan of the Local 705 Pension Fund type.

The result of the holding below is that Congress—which in ERISA made the decision not to burden plans with retroactive liabilities—was aware of and acquiesced in such liabilities under

the securities acts. Based upon the legislative histories of the relevant statutes and the effect of the decision below on the nation's private pension system, such a bizzare intent cannot be attributed to Congress. Finally, § 17 of the 1933 Act does not create an implied private claim for fraud.

ARGUMENT.

I.

THE RELATIONSHIP BETWEEN THE LOCAL 705 PENSION FUND AND A PARTICIPANT IS NOT IN ECONOMIC REALITY AN INVESTMENT CONTRACT.

A. The Court Below Relied on the Literal Approach to the Statutes and Misapplied This Court's Decisions Concerning Variable Annuity Contracts.

Securities acts coverage "turn[s] on the economic realities underlying a transaction" whatever may be the literal words of the definitional sections. *Forman*, 421 U. S. at 849 & n.14. The court of appeals turned *Forman* on its head and disregarded economic reality, even where the statutory language does not literally include interests in pension funds, when it decided that the Local 705 Pension Fund sold an investment contract to a nonvested participant. In the few pages nominally devoted to the economic realities test, and proceeding from the fiction that a nonvested participant has an undivided interest in the Local 705 Pension Fund and a misreading of *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U. S. 65 (1959) (*VALIC*), and *SEC* v. *United Benefit Life Ins. Co.*, 387 U. S. 202 (1967), the court analogized the Local 705 Pension Fund to a mutual fund and to the issuer of a variable annuity contract (App. 230a-33a).

VALIC held a variable annuity contract to be a security rather than insurance because the "standards for investment of funds underlying these annuities have . . . two new features. First, premiums collected are invested to a greater degree in common stocks and other equities. Second, benefit payments vary with the success of the investment policy." 359 U. S. at 69. In other words "they guarantee nothing to the annuitant except an interest in a portfolio of common stocks or other equities—an

interest that has a ceiling but no floor." *Id.* at 72-73 (footnotes omitted). Lack of a guarantee of fixed income makes the variable annuity contract a security because it "places all the investment risks on the annuitant, none on the company. The holder gets only a pro rata share of what the portfolio of equity interests reflects—which may be a lot, a little, or nothing." *Id.* at 71 (footnote omitted).

United Benefit considered an insurance company's "Flexible Fund' " where the purchaser's fixed premium was placed in a separate account and invested principally in common stocks. 387 U. S. at 205. Prior to maturity the purchaser could withdraw either a proportionate share and interest from the fund or the cash value measured by a percentage of the paid net premiums. *Ibid.* At maturity the purchaser had two options: Either receive the cash value of the policy or convert the interest in the fund into a fixed benefit life annuity. In either event the purchaser's interest in the fund was terminated. *Id.* at 205-06. For purposes of the security transaction analysis, this Court separated the contract's prematurity from the postmaturity options because "[t]wo entirely distinct promises are included in the contract and their operation is separated at a fixed point in time."[14] *Id.* at 207. The postretirement life annuity was conceded to be "purely conventional insurance provisions, and thus beyond the purview of the [Commission]." *Id.* at 206. The accumulation portion of the contract was deemed to be an investment contract because, as in *VALIC*, "benefits continued to flucuate with the fortunes of the fund," *id.* at 209-10, and, like mutual funds, the company's advertisements "appeal[ed] to the purchaser not on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management," *id.* at 211 (footnote omitted).

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14. Because the Local 705 Pension Fund makes only one promise (to pay a vested participant the fixed life annuity) operable at one period in time (postretirement), *United Benefit* does not support the court of appeals' unrealistic dissection of the promise into an employment aspect and a security (App. 231a-32a).

The Local 705 Pension Fund is clearly unlike the variable annuity contracts. *See Los Angeles Dept. of Water & Power* v. *Manhart*, ____ U. S. ____, slip op. 18 (1978). Because the plan documents disclaimed an intent to grant to a nonvested participant any interest in the fund assets, respondent had no such interest. *See Craig* v. *Bemis Co.*, 517 F. 2d 677, 680-81 (5th Cir. 1975); *Guinzy* v. *Curtice Burns, Inc.*, 28 Ill. App. 3d 398, 400 (1975), 327 N. E. 2d 284, 286. Whereas the variable annuitant has a separate and definable interest in the premiums and investment return allocable thereto, *VALIC*, 359 U. S. 73 n. 14; *United Benefit*, 387 U. S. at 205, 208, the nonvested plan participant has no interest whatsoever in the pool of contributions but is only a possible participant in benefits to be paid from the pool of contributions. *See Sheetmetal Workers Local 5* v. *Mahoning & Trumbull Bldg. Trades Welfare Fund*, 541 F. 2d 636, 639 (6th Cir. 1976).

The Local 705 Pension, which compels the employee's participation, does not offer the participant growth income pegged to the fund's acumen in the securities markets; it promises only that a vested participant will receive a postretirement fixed lifetime annuity with any balance payable to an eligible survivor. The employees, through Local 705, "in bargaining for establishment of the Trust, were obviously interested in creating a sound, comprehensive plan 'rather than making an investment for profit.' The Trust simply cannot be characterized as one of the 'countless and variable schemes devised by those who seek the use of money of others on the promise of profits.' " *Robinson* v. *Mineworkers Health & Retirement Fund*, 435 F. Supp. 245, 247 (DC 1977); *accord Hurn* v. *Plumbing Retirement Fund*, 434 F. Supp. 80 (CD CA 1976); *Wiens* v. *Teamsters Union*, BNA Sec. Reg. and L. Rep. No. 397 at A-13 (CD CA 1977).

The court below did not understand the nature of a defined benefit plan when, in analogizing the Local 705 Pension Fund to a mutual fund, it created a direct correlation between the plan's investment income and the level of benefits (App. 227a,

229a, 231a). Investment income is but one of several factors which comprise the actuarial assumptions used to determine the cost of the plan (App. 172a-73a). The investment income assumption is a projected future percentage rate predicated upon the fund's past investment experience. Because actuarial assumptions " 'reflect long-term trends rather than give undue weight to recent experience' " (App. 173a), the plan's short term investment performance has no effect on costs. If the plan's long term experience were to require a downward revision of the existing assumption, the effect would be to increase the cost of the plan. Contrary to the opinion of the court below, this increased cost would not necessarily affect the promised pay-out. It might be absorbed by the present level of contributions; or by extending the period for funding if the maximum has not been reached; or by favorable changes in participant entry, retirement, death, withdrawal, or disability; or by the union and the employers negotiating an increase in the employers' rate of contributions; or by a combination of two or more of these factors.

In a superficial discussion of economic reality the court below raised the argument that if pension fund investments in the capital markets, "which in the aggregate control a quarter or more of the entire capital market are exempt from the anti-fraud provisions of the securities laws, then policing of the capital markets is significantly neutralized" (App. 233a, 241a, 242a). The analysis has at least two flaws: The first is that only pension funds which invest in the capital market are subject to the securities acts. Securities acts coverage would occur if the plan bought a single stock or bond but not if the assets were deposited in savings accounts; an anomalous and inconsistent approach. Second, the court "polices" the capital market by controlling the noninvestment functions of the plan. A like argument was rejected by this Court as "better left to the Congress, which can assess both the costs and benefits of any such regulation." *Forman,* 421 U. S. at 859 n. 26.

B. Collectively Bargained Welfare Funds Have Been Discretely Regulated by Congress in the Labor Statutes and the Commission Acknowledged Their Dissimilarities to the Capital Market.

The economic realities of collectively bargained pension funds are best viewed from Congress' perspective of these plans as a form of private social security to be discretely regulated by the labor statutes. The legislative histories of the labor statutes show that Congress and the Commission viewed collectively bargained plans as being outside of the securities acts' milieu —a position which the Commission renounced in the court below—and explain the absence of a demonstrable congressional intent to place these plans' noninvestment functions under the securities acts' antifraud provisions.

1. Section 302(c)(5) of the Labor-Management Relations Act of 1947.

State laws aside, before 1947 the only regulation of pension funds was found in § 165 of the Internal Revenue Code of 1939, 53 Stat. 1, which exempted from income taxation an employee pension or profit-sharing trust and the employer contributions thereto. Section 165's purposes were that the fund be

> operated for the welfare of the employees in general and to prevent the trust device from being used for the benefit of shareholders, officials or highly paid employees, and to insure that it shall be impossible for any part of the corpus or income to be used for purposes other than the exclusive benefit of the employees.

Commissioner v. *Produce Reporter Co.*, 207 F. 2d 586, 587 (7th Cir. 1953). Section 401(a) of the Internal Revenue Code of 1954 picked up and expanded upon § 165.

In 1946 the Senate became concerned "by the demand made . . . on the part of the United Mine Workers that a tax of 10 cents a ton on coal be paid to the Mine Workers Union for indiscriminate use for so-called welfare purposes." S. Rep.

No. 105, 80th Cong., 1st Sess. 52 (1947). The result was § 302 of the Labor-Management Relations Act of 1947 (LMRA), 29 USC § 186, "to deal with problems peculiar to collective bargaining * * *, and was aimed at practices which Congress considered inimical to the integrity of the collective bargaining process." *Arroyo* v. *United States,* 359 U. S. 419, 424-25 (1959).

> To remove these dangers, specific standards were established to assure that welfare funds would be established only for purposes which Congress considered proper and expended only for the purposes for which they were established. . . . Continuing compliance with these standards in the administration of welfare funds was made explicitly enforceable in federal district courts by civil proceedings under § 302(e). The legislative history is devoid of any suggestion that defalcating trustees were to be held accountable under federal law, except by way of the injunctive remedy provided in that subsection.

Id. at 426-27 (citation and footnote omitted).

Thus, Congress entered the private pension field for the very limited purpose of correcting abuses by administrators of collectively bargained welfare funds. Even then it chose to regulate only the structure and the purposes of the funds. As to the former it required a written plan and a trust managed by equal representatives of the employer and the employees, while the latter tracked the "for the exclusive benefit of the employees and their beneficiaries" language of § 165 of the Internal Revenue Code of 1939. Section 302(c)(5), which governed the structure of the Local 705 Pension Fund, was but a "stopgap" measure until Congress could more fully study the welfare field and its problems. 2 Legislative History of the Labor-Management Relations Act of 1947 at 1313 (remarks of Sen. Taft).

2. The Welfare and Pension Plans Disclosure Act Eschewed Substantive Regulation of Welfare Funds After Congress Had Heard the Commission's Views on Regulation.

Congress' next piece of remedial legislation was the Welfare and Pension Plans Disclosure Act (WPPDA), 72 Stat. 997, and the 1962 amendments, 76 Stat. 35. The court of appeals was correct that after 1940 the number and magnitude of welfare plans progressed at a rapid and expanding rate (App. 232a); a fact of which Congress was fully aware when it passed § 302, 2 Leg. Hist. 1947 at 1314; note 22 *infra*, and when it embarked on consideration of bills which were to become the WPPDA, 104 Cong. Rec. 7049, 7053 (1958); 108 Cong. Rec. 1924 (1962).

"Congressional consideration of the problems in the pension field began in 1954 * * *. In the next four years, through hearings, studies and investigations, a Senate subcommittee canvassed the problems of the nearly unregulated pension field and possible solutions to them." *Malone* v. *White Motor Corp.*, ... U. S. ....., 55 L. Ed 2d 443, 451, 452 (1978). Congress' opinion that venturing into the area of welfare plan disclosure "is an entirely new field", 104 Cong. Rec. 7231 (remarks of Sen. Kennedy), and that "no Federal Statute, regulation or authority . . . provided protection for pension plan beneficiaries," S. Rep. No. 1734, 84th Cong., 2d Sess. 60 (1956), was formed with full knowledge that greater protections were afforded to investors by the securities acts:

> The inadequacies of safeguards at either the State or Federal level to protect those who rely on the security afforded by these plans are in sharpest contrast to the protection furnished comparable large scale public savings and investments by the Federal Deposit Insurance Act, and the Securities and Exchange Act of 1933 [sic], the Investment Company Act of 1940, and so forth.

S. Rep. No. 1440, 85th Cong., 2d Sess. (1958), *reprinted in* [1958] U. S. Code Cong. & Ad. News 4145.

233a) as supporting respondent's interest in the Local 705 Pension Fund as an investment contract. As a matter of "policy" it justified Congress' failure to specifically mention pension plans because it said that "in the early 1930's pension plans were still a rarity" (App. 241a). Nevertheless, because since 1955 "the asset value of pension plans" has grown and pension plans "are now the major, if not sole, form of investment for most American workers to provide for their old age and because of the now crucial role that such plans play in today's capital markets, they are just the sort of investment vehicle that the securities acts were passed to regulate" (App. 241a).

The court of appeals concluded that respondent's labor for his employer as a truck driver and the employer's contributions on his behalf for such labor resulted in a disposition of a security for value between respondent and the Local 705 Pension Fund and thereby a "sale" under the securities acts. Volition on the part of the employee is not a condition precedent to a sale, however, volition is found in union membership ratification of the collective bargaining agreement negotiated by Local 705 and in the employee's decision to accept and retain covered employment (App. 244a-45a).

The Commission advised the court of appeals that its position that employee participation in a noncontributory mandatory pension plan does not constitute a sale applies to the registration but not to the antifraud provisions of the securities acts. A majority of the court of appeals accepted the representation (App. 245a-46a). However, Judge Tone, concurring, found that the Commission had indeed changed its position and "has not been as candid as we might have hoped in acknowledging and explaining its change of position" (App. 260a).

The court of appeals, following its prior decisions, concluded that § 17(a) of the 1933 Act creates a private cause of action. It then analyzed the relationship between the Employee Retirement Income Security Act of 1974 (ERISA), 29 USC §§ 1001 *et seq.*, and the securities acts, and the effect of its decision on

the national labor policy. The court of appeals erroneously attributed to the petitioners and their *amici* the argument, which they had expressly disclaimed, that ERISA "has repealed[11] the anti-fraud provisions of the [securities acts] insofar as they apply to union pension funds", and concluded that no repeal has occurred (App. 250a).

According to the court below, ERISA's savings clause and failure (1) to provide relief to the employee at the time the employee accepted employment or ratified the collective bargaining agreement or before ERISA's effective date,[12] or (2) to generally prohibit "the making of false or misleading representations to an employee concerning the pension fund" (App. 255a n.57), led it to conclude that ERISA and the securities acts' antifraud provisions serve distinct and complementary purposes. Additionally, the timing, method and content of disclosure to employees is less stringent under ERISA than under the securities acts.[13] "Thus the anti-fraud provision of the securities acts will protect the interests of an investor before he makes an investment decision, while ERISA serves employees who have been employed for a substantial period of time at a job covered by a pension plan, protecting them from losing benefits through ignorance of the plan provisions" (App. 255a).

The extensive arguments made by the Secretary of Labor and petitioners that the district court's decision seriously conflicts

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11. The court of appeals used the terms "repeal" and "preemption" interchangeably (App. 250a, 251a).

12. Section 514(b)(1), 29 USC § 1144(b)(1), provides that "[t]his section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before January 1, 1975."

13. E.g., "Affirmance of the judgment below will supplement ERISA by providing a self-executing compulsion to disclose adequate information at such times, including a statistically determinable risk that many employees covered by a plan will never receive their pension benefits" (App. 255a). The Secretary of Labor's regulations fleshing out the requirement of § 102(b) of ERISA, 29 USC § 1022(b), that a participant be told "circumstances which may result in disqualification, ineligibility, or denial or loss of benefits" were deemed inadequate by the court of appeals (App. 255a n.58).

Id. at 653. In the end, Congress deliberately rejected substantive regulation of pension funds by any federal agency or person for disclosure in the form of filings with the Labor Dept. *Malone*, 55 L. Ed. 2d at 452; a point which the court below refused to accept (App. 252a-53a).

By 1962 President Kennedy and the Congress were dissatisfied with the experience under the act. Nevertheless, Congress was not of a mind to venture beyond disclosure and into regulation of welfare funds. 108 Cong. Rec. 1732, 1738, 1924 (1962). The debates over which agency should administer the act again point up Congress' and the Commission's views that collectively bargained welfare funds have no relationship to the objects of the securities acts. Senator Tower's proposal that the Commission replace the Secretary of Labor in the administration of the act sparked a significant response from the bill's sponsor.

> SENATOR MCNAMARA. * * * I assume that the amendment is based on the belief that the regulation of pension and welfare plans involves primarily a question of investment practices and that the SEC is the agency best qualified to supervise matter of this kind.
>
> This line of reasoning has surface appeal, but I think it ignores the basic issue.

Id. at 1932. After noting that a pension or welfare program "is a contractual obligation between employer and employee", *ibid.*, he continued:

> Given this overriding labor-management factor, it seemed obvious to the committee that the governmental administration should be entrusted to that agency which had experience in and understanding of labor-management relations.

Ibid. He then introduced a memorandum from the Commission repeating in greater detail its earlier view of the disparity

in economic reality between a security and a collectively bargained pension fund.[16]

It is against the background of the WPPDA that the final piece of pension plan legislation must be viewed.

3. The Employee Retirement Income Security Act of 1974.

ERISA was enacted after the claimed acts and omissions in this case occurred. Nevertheless, the statute is relevant to the issues because it details Congress' delicate but comprehensive solution to vesting and disclosure problems.[17]

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16. As pertinent:

> It is true that the Commission and its staff have developed an expertise in the areas of financial analysis of corporate securities and full disclosure of financial information. However, *this expertness has been developed in the context of statutes having as their broad purposes the prevention of fraud in the securities markets,* the regulation of brokers and dealers and the stock exchanges, and the publication by issuers of significant information concerning their management, operations and securities *without reference to the special problems in the labor-management field.* An agency which has a closer contact with the needs and problems in the labor-management field and a more intimate knowledge of related statutes should be in a better position to determine the appropriate criteria for the administration of welfare and pension plan legislation. *The plans which are involved are the fruits of collective bargaining and accordingly, are inseparably intertwined with labor-management relations. Abuses in this area would have their main effect in an economic area in which this Commission does not possess expertise.* In addition, the task that would be imposed under the proposed amendment to the bill could tend to overshadow the Commission's present work. This would be especially serious at the present time when the Commission is conducting a study of the securities markets and is faced with serious and ever-increasing problems which demand the Commission's full attention.

108 Cong. Rec. 1933 (1962) (emphasis added).

17. Petitioners have not argued that ERISA preempts the securities acts (App. 250a). We cited the statute as the most recent example of congressional action in the welfare plan field and support for the proposition that "since it was universally believed pension funds were outside the scope of the securities acts, Congress saw no need to explicitly exempt a truism" (App. 251a). However, the opinion indicates that the court below believed that preemption

(Footnote continued on next page.)

> In 1974, Congress underlined the importance of making only gradual and prospective changes in the rules that govern pension plans. In that year, Congress passed a bill regulating employee retirement programs. . . . The bill paid careful attention to the problem of retroactivity. It set a wide variety of effective dates for different provisions of the new law; some of the rules will not be fully effective until 1984, a decade after the law was enacted.

Manhart, slip op. 18 n. 40 (citations omitted). "The length and detail of . . . [ERISA] indicate that the regulation of pension funds with regard to such matters as vesting and procedural rights is a complex task more appropriate for Congress than for the courts." *Lugo* v. *Employees Retirement Fund*, 529 F. 2d 251, 255 (2nd Cir. 1976), *cert. denied*, 429 U. S. 826 (1976).

Section 2[18] of ERISA, which in the area of disclosure is lifted from § 2 of the WPPDA, evidences Congress' clear intent to

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(Footnote continued from preceding page.)

occurred. The court's basic premise is that the securities acts always applied to preemployment and postemployment material misrepresentations. Yet, as discussed *infra* at 39-40, the court below stated that ERISA cut off the securities acts' viability to postemployment occurrences.

18. Section 2, 29 USC § 1001, provides as pertinent that Congress' purposes in passing ERISA were:

* * * * *

(b) * * * to protect . . . the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts.

(c) * * * to protect . . . the interests of participants in private pension plans and their beneficiaries by improving the equitable character and soundness of such plans by requiring them to vest the accrued benefits of employees with significant periods of service, to meet minimum standards of funding, and by requiring plan termination insurance.

address the nub of respondent's complaint, i.e., lack of disclosure, arbitrary vesting terms and diversion of plan assets. Congress' intent became ERISA's four titles. Title I—Protection of Employee Benefit Rights—contains five subparts dealing with reporting and disclosure, participation and vesting, funding, fiduciary responsibility, and administration and enforcement. Section 502(a), 29 USC § 1132(a), permits the Secretary of Labor or a participant or beneficiary to bring suit to redress violations of the trustees' fiduciary duties or to enjoin any act or practice which violates ERISA, or by a participant against a pension plan as an entity to recover benefits. Title II amends the Internal Revenue Code. Title III allocates jurisdiction between the Secretary of Labor and the Secretary of the Treasury. Title IV deals with plan termination insurance.

Congress addressed the problem of plan vesting requirements with full knowledge that inequities abounded. Legislative History of the Employee Retirement Income Security Act of 1974 (Leg. Hist. ERISA) 591. Part 2 of ERISA, §§ 201-211, 29 USC §§ 1051-1061, minutely details new minimum vesting criteria, establishes standards for determining years of credited service, curtails forfeitures caused by breaks in service, and permits suits to enjoin violative procedures. Nevertheless, the very pervasiveness of perceived abuses in the requirements for pensions led Congress to shun the facially appealing perogative of applying all of the new standards retroactively; to do so would have adversely affected the plans' ability to meet present and future costs. Leg. Hist. ERISA 4673. The result was that "[f]or years beginning prior to the effective date of the vesting provisions, a plan may apply the break-in-service rules provided under the plan, as in effect from time to time." H. R. Rep. No. 1280, 93d Cong., 2d Sess. 270 (1974); ERISA, § 203(b)(1)(F), 29 USC §1053(b)(1)(F).

The court below characterized Congress' concern as "[t]he parade of horribles offered by the defendants and the *amici* who support their position . . . [which] results mainly from their

zeal as advocates and should not distract a court from enforcing the Congressional policies contained in the anti-fraud provisions of the securities laws" (App. 258a; footnote omitted). That characterization was unfair. On March 20, 1978 "an actuarial study of the potential effects which might result if the Supreme Court affirms the decision of the [court below]"[19] was presented to the Secretary of Labor. The potential liability "to all pension and profit sharing plans in the United States . . . if the applicable statutes of limitations run from the [nonvested participant's] date of termination of employment" ranges from $3.5 billion to $13.5 billion depending on the years of service of terminated nonvested participants (DOL Study I-3, I-4). If the statutes "run from normal retirement date," the potential liabilities escalate to a range of $10.1 to $39.6 billion (DOL Study I-4).

Before the DOL Study was released the Local 705 Pension Fund commissioned its actuary to perform a study of the effects of the decision below on its participants and the plan's ability to perform the promised payment of defined benefits. That study (Hansen Study) is contained in the Hansen affidavit appended to this brief at A3-A4, A16-A23 *infra*, with the supporting data at A24-A31 *infra*. The methods and procedures of the two studies are quite similar.[20] The Hansen Study applies to the Local 705 Pension Fund several assumptions derived from the opinion below. First, that the plan had not disclosed " 'the actu-

19. Grubbs, Report To The Secretary Of Labor, Potential Effects Of *Daniel* (March 20, 1978) (DOL Study).

20. The DOL Study was restricted to nonvested terminated participants while the Hansen Study also calculated liabilities for present active participants. The measure of damages was full and immediate vesting for the potential claimants in the DOL Study; the Hansen Study used a "refund" of contributions. The DOL Study pointed out that "another possible measure of damages is the accumulated employer contributions paid to the pension fund on behalf of the individual. • • • (DOL Study II-5). Finally, the Hansen Study did not take into account the statutes of limitations basically because the district court did not close the door on "allegations that misrepresentation began twenty years ago . . ." (App. 108a, 109a-11a).

arial probability . . . that a member will actually receive pension benefits, and factors such as risk of loss, breaks in service, death before retirement age, and plan termination' " (A3); the reason being that "[t]he information regarding each participant apparently required to be disclosed is not the type of information which a plan actuary uses"[21] (A4, A14). Second, that the failure to disclose the precise information results in plan liability to participants. Finally, that the measure of damages "is the value of the contributions made by his or her contributing employer under the terms of the collective bargaining agreements in effect during the participant's period of plan participation or immediate and full vesting in the benefit earned to date (accrued benefit) at the time of termination" (A4).

The Hansen Study made separate calculations for 6048 individuals who terminated plan participation within the ten years before January 31, 1977 and who were not eligible for any benefit (terminated participants), and active participants in the plan on that date (active participants) (A17, A18 *infra*). Using the assumption that the terminated participants would be entitled to a payment equal to the accumulated contributions based on the rate in effect during participation, the actuary calculated the total dollar amount of potential plan liability with and without interest and the increase in the employer contribution rate necessary to meet this financial drain. As an alternative, the actuary calculated the required increased employer contribution if the plan were to provide for one hundred per cent immediate vesting for the terminated participants. Like assumptions and calculations were made for the active participants except that an individual in that group had the choice of terminating plan participation and cashing in or remaining in the plan to receive a benefit per the plan formula. Hansen "assumed that the decision would be a purely financial one, i.e., the participant would select the refund in cases where the present value of the benefit earned to date was less than the refund amount. This assumption

21. *Accord* DOL Study I-5, Part IV.

does not take into account any other considerations that may influence the [active] participant's decision" (A18). Finally, in order to account for an inability to know the mix of either class of potential claimants and that not all claimants may receive damage awards, the results were formulated as a percent diversion of fund assets to each class and both classes of claimants ranging downward from one hundred percent to twenty-five percent.

Because the results are summarized in Table 1 (Effect of Diversion of Fund Assets) (A20 *infra*) and Table 2 (Effect of Diversion On Contribution Rates) (A22), we shall not detail either the dollar or percentage impact on the fund, its remaining participants and retirees, and the employers. Suffice it to say that the fund will, in all probability, terminate simply because it is unrealistic that the employers would agree to increase the *weekly* contribution by 257.5% (from $33 to $117.97) and up to 605% ($232.62) to maintain the existing plan in order to pay those who are not eligible for pensions. And as the Hansen Study reveals, whether the plan terminates, the decision below provides a windfall of millions—and maybe over one hundred million—of plan dollars to individuals who have not satisfied the plan's eligibility rules to the prejudice of the 3117 retirees and 6,690 vested active participants who have met the eligibility rules.

It is this result which the court of appeals said that Congress countenanced: the same Congress which agonized over ERISA and opted for no retroactive vesting liabilities on the one hand was on the other fully aware of and acquiesced in unlimited retroactive liabilities under the securities acts sufficient to devestate the nation's private pension plans. Congress would hardly act in such a schizoid manner.

In ERISA, Congress also considered the problem of inadequate disclosure which it had wrestled with in the WPPDA. Based on findings "that an average plan participant, even where he has been furnished an explanation of his plan provi-

sion, often cannot comprehend them because of the technicalities and complexities of the language used," Leg. Hist. ERISA 597 (remarks of Rep. Ullman), Congress again chose to legislate prospectively. The reporting and disclosure rules specified the precise information to be disclosed and that disclosure must be "written in a manner calculated to be understood by the average plan participant. . . ." ERISA, 102(a)(1), 29 USC § 1022(a)(1); see also §§ 101-11, 29 USC §§ 1021-31.

With respect to the claimed diversion of funds, besides the existing criminal statutes, e.g., 29 USC § 186(d) and 18 USC § 1954, ERISA details the trustees' fiduciary duties, 29 USC §§ 1104, 1105; prohibited transactions, 29 USC §§ 1106, 1107; and liability both criminal, 29 USC § 1131, and civil, 29 USC §§ 1109, 1132(a)(3). The Secretary of Labor has jurisdiction to sue for the breach of fiduciary duty, 29 USC § 1132(a)(5), the right to intervene in private suits (except where "solely" to recover benefits), 29 USC § 1132(h), and to initiate investigations, 29 USC § 1134.

The court of appeals, however, decided that plan participants deserve protections not afforded by ERISA or the other labor statutes. It saw Congress' efforts in regard to vesting and disclosure—although complex and careful—as being less than it would have enacted. It attempted to avoid a head on confrontation with ERISA by establishing an artificial point of departure: the securities acts, not ERISA, reach the preemployment period, i.e., before the person "makes an investment decision. . ." (App. 225a); ERISA enters only upon the post employment scene. However, as the legislative histories of the labor statutes prove, Congress made the decision if and at what point in time disclosure was to be made. In the WPPDA disclosure was made indirectly to the participant via the Labor Department files. In ERISA Congress placed on the plan administrator the duty to disseminate disclosure materials directly to the plan participants. Nevertheless, the disclosure material is on file and any prospective covered employee can view the documents. The

artificiality of the preemployment—postemployment dichotomy is exposed by the court's application of the securities acts to postemployment (ERISA covered) occurrences such as "subsequent contract ratifications" (App. 255a), respondent's "material reliance on pension benefits in retaining his job" (App. 246a n. 41), and plan amendments (App. 249a n. 46). And in the end it acknowledged that ERISA applied to respondent and must be accommodated in some vague fashion by the district court (App. 256a) even though it said that the securities acts, not ERISA, govern.

The court below relied upon ERISA's savings clause, § 514(d), 29 USC § 1144(d), as evidence that Congress did not intend to affect the application of the securities acts antifraud provisions to welfare plans. Section 514(d) paraphrases § 10(b) of the WPPDA. Section 10(b) was part of a statute designed by a Congress which had heard disclaimers of the applicability of securities acts' principles to these plans and which had " 'no desire to get the Federal Government involved in the regulation of these plans,' " *Malone* 55 L. Ed. 2d at 452. Unless there were a congressional change of mind between 1962 and 1974, ERISA's savings clause means no more than did § 10(b). The court below finds that change in a 1971 Senate Report which, in the course of surveying federal regulation of pension funds, refers to the securities acts. Interim Report, Senate Comm. on Labor and Public Welfare, S. Rep. No. 92-634, 92d Cong., 2d Sess. 96 (1972) (App. 252a).

The Senate Report said that "[p]ension and profit sharing plans are exempt from coverage under the Securities Act of 1933"; a statement which is not contrary to our reading of the statutes but for reasons different than the court of appeals'. The report then discusses a voluntary pension plan which "invests in the securities of the employer company an amount greater than that paid into the plan by the employer" as being required to be registered. Thus the report cannot be used as a basis for finding congressional awareness of, let alone acquiescence in,

the Commission's present view of the applicability of the securities acts' registration sections, let alone the antifraud provisions, to the Local 705 Pension Fund, a collectively bargained mandatory noncontributory pension plan which does not invest in the employer's securities. In any event, this "isolated comment . . . cannot change the effect of the plain language of the statute [ERISA] itself." *Manhart*, slip op. 11.

We now turn to a short review of the securities acts' legislative histories more fully canvassed in the International Union's brief, keeping firmly in mind that in the more than four decades since their enactment no reported case has upheld the theory of the court below. "It is unlikely that if Congress had indeed wrought such a major expansion of federal . . . jurisdiction in enacting the [securities acts], its actions would have so long passed unobserved," *United States* v. *Enmons*, 410 U. S. 396, 410 (1973); "it would require statutory language much more explicit than that before us here to lead to the conclusion" reached by the court below, *id.* at 411.

C. The Securities Acts' Legislative History Shows No Intention to Cover the Relationship Between a Participant and a Mandatory Noncontributory Pension Fund.

While conceding that the legislative histories of the 1933 and 1934 acts are "silent on the question" of coverage of pension plans of the type at issue here[22] (App. 233a), the court of

22. It explained the silence by the assumption that private pension plans were then too insignificant for Congress' explicit concern (App. 241a). The facts are that between 1900 and 1933 about 4 million workers were covered under private retirement plans of 800 industrial institutions. *Proposed Amendments to the Securities Act of 1933 and to the Securities and Exchange Act of 1934: Hearings before the House Comm. on Interstate and Foreign Commerce*, 77th Cong., 1st Sess. 966 (1941). By 1930 private plans, excluding railway employees, annually paid $90 million in benefits to about 100,000 retirees, and had assets of $800 million. American Council of Life Insurance, *Pension Facts 1976* at 8. As early as 1928 Congress had considered private retirement plans of sufficient importance

(Footnote continued on next page.)

appeals found coverage by amendments proposed but not enacted in 1934, 1941 and an amendment adopted in 1970.

1. The Rejected 1934 Amendment to § 4(1) of the 1933 Act.

In 1934 the Senate adopted Senator Hastings' amendment to § 4(1) of the 1933 Act to exempt from registration

> an offering made solely to employees by an issuer or by its affiliates in connection with a bonafide plan for the payment of extra compensation or stock investment plan for the exclusive benefit of such employees.[23]

73 Cong. Rec. 8708 (1934). When the amendment was presented to a conference committee

> [t]he conferees eliminated the third proposed amendment to this subsection on the ground that participants in *employees' stock-investment plans* may be in as great need of the protection afforded by the availability of information concerning the issuer for which they work as are most other members of the public.

H. R. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934) (emphasis added). The court below excised from the report the italicized phrase and all that went before it (App. 233a), and cited the balance to support its conclusion that the phrase "as great need of the protection" showed congressional consideration of the type of employee plans at issue here (App. 235a n. 32). The full statement proves only that the conferees' concluded that employees offered employee *stock* plans were in the same need of protection as any other purchaser of *stock*. *See* 73 Cong. Rec. 10181-82 (1934).

(Footnote continued from preceding page.)
to encourage their formation through exemptions from income taxes. Revenue Act of 1928, 48 Stat. 795, § 165. The explanation therefore is the more obvious one that such coverage was too remote from the subject of the legislation to be mentioned.

23. The court of appeals substituted "employees *of* an issuer or *of* its affiliates" (App. 233a; emphasis added) for "by".

2. The 1941 Rejected Amendment.

In 1941 the Commission proposed amendments exempting specific types of pension plans from the 1933 Act's registration requirements. *Proposed Amendments to the Securities Act of 1933 and to the Securities and Exchange Act of 1934: Hearings before the House Comm. on Interstate and Foreign Commerce,* 77th Cong. 1st Sess. 907-08, 950 (1941) (1941 Hearings). Commission member Purcell expressed his opinion that Congress' rejection of the 1934 amendment showed Congress' intent that an employee pension plan involving a sale was an investment contract for purposes of the securities acts' registration provisions. 1941 Hearings 895-96, 904-05. Because the Commission did not then consider that a sale existed between the employee and a mandatory noncontributory plan, *id.* at 896-97; App. 245a-46a, Purcell's personal view did not, as the court of appeals' description conveys (App. 234a, 235a), extend to pension plans generally and stopped well short of the Local 705 Pension Fund. Moreover, Congress' failure to act on the Commission's proposal and the contrary views of members of Congress, 1941 Hearings 870-72, 878, 888, 894-95, 913, 975, bar an inference of congressional acquiescence in Purcell's interpretation of the 1934 amendment.

3. The Investment Companies Amendment of 1970.

The 1970 amendment has nothing whatsoever to do with this case: It deals only with single and collective trust funds maintained by a bank or in a separate account maintained by an insurance company which it exempts from registration but not from the antifraud provisions. The amendment was drafted to deal only with the question of whether banks and insurance companies are required to register their sales of interests in trust funds which they maintain for employee pension plans. 114 Cong. Rec. 23051, 23052 (1968); S. Rep. No. 91-184, 91st Cong., 1st Sess. 10, 11 (1969). It does not address and therefore says nothing at all about the status of interests in the pension plan itself; that issue was not then considered.

The Commission's views on the proposed legislation could only have reinforced Congress' outlook that the securities acts were inapplicable to collectively bargained pension plans. *See, e.g., id., reprinted in* [1958] U. S. Code Cong. & Ad. News 4138, 4156; H. R. Rep. No. 2283, 85th Cong., 2d Sess. (1958), *reprinted in* [1958] U. S. Code Cong. & Ad. News 4181; 104 Cong. Rec. 7062 (1958). The court below said that the Commission declined to administer the proposed bill only because it was too busy and because the participants had no say in the funds' investment policies (App. 252a n. 53). That is just not true.

Acting Commission chairman Andrew D. Orrick's testimony to the Senate subcommittee confirms that the Commission acknowledged both the differences in economic reality between a collectively bargained pension fund and a security and "the intricate problems in this specialized field", 104 Cong. Rec. 7049 (1958) (remarks of Sen. Kennedy):

> MR. ORRICK. I feel, Senator, that the expertise of the Securities and Exchange Commission doesn't lie particularly or at all in the labor field.
>
> SENATOR IVES. • • • In the first place, sir, does your Commission really desire to have this function added to its other functions? • • •
>
> • • • • •
>
> MR. ORRICK. The functions of the Securities and Exchange Commission are devoted to the regulation of the *capital-securities markets.* And we do have experts among our staff in analyzing corporate financial statements by accountants, and our lawyers are expert in the analysis of full-disclosure provisions.
>
> *But the area covered by a bill on welfare and pension funds does not, as such, deal with the capital-securities markets.*

Hearings on S. 1122 et al. Before the Senate Subcomm. on Welfare and Pension Plan Legislation of the Senate Comm. on Labor and Public Welfare, 85th Cong., 1st Sess. 106, 107

(1957) (emphasis added). His views were incorporated in a Commission supplemental memorandum.[15] *Id.* at 119.

With knowledge of the securities acts' processes, 104 Cong. Rec. 7492, 7493 (1958), Congress believed that the bill for the first time required plans to register with the agency which Congress would select to administer the bill. "Registration is that act by which the manager or operator of a fund registers his fund with a designated agency." 104 Cong. Rec. 7056 (1958) (remarks of Sen. Allott); S. Rep. No. 1440, *reprinted in* [1958] U. S. Code Cong. & Ad. News 4156. While aware of plan "unexpected termination; inadequate funding; [and] unfair vesting requirements," *Malone*, 55 L. Ed. 2d at 454, Congress stopped at registration with the Labor Department and thereby indirect disclosure to plan participants.

Congress rejected proposals that would have authorized private suits of the type adopted by the court below. Bernard Meltzer, of the University of Chicago Law School, in response to a "reference to the [existing] SEC legislation," proposed "provisions setting up standards which could be implemented by civil suits for breach of these standards or fiduciary relationships generally. And the latter standards would not have to be so precise." *Hearings, supra,* at 450, 451, 457, 463. Archibald Cox proposed that the Commission be authorized to sue for plan beneficiaries to "enforce the due application of their funds and to prevent breaches of trust in the administration thereof. . . ."

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15. Rather than advising the subcommittee that in its view there already rested on plan administrators a duty of disclosure for the breach of which there existed a private antifraud remedy, the Commission's memorandum gave a contrary impression. Under *"The need for regulatory legislation,"* the Commission discussed "how far beyond disclosure should Congress go," and concluded:

> In answer the Commission suggests that regulation of the type Senator Kennedy suggests is desirable. It is limited regulation in that it only *establishes* fiduciary standards. With this the Commission concurs. It believes from its study of the reports heretofore made that *limited regulation of this type is in the public interest.*

Hearings, supra, at 120 (emphasis added).

the employees because the money used to purchase them is not the employees' money. However, there are other reasons why the *Morgan, Kennedy* rationale fits squarely here. *Morgan, Kennedy* was based on broader grounds than the court below would admit:

> We are hard pressed to discern *any* of the usual traits of a customer relationship between the employee-beneficiaries and the debtor. *Black's Law Dictionary* (4th Ed., 1951) defines a "customer" as
>
> > One who regularly or repeatedly makes purchases of, or has business dealings with, a tradesman or business house. Ordinarily, one who has had repeated business dealings with another. A buyer, purchaser, or patron. (Citations omitted.)
>
> The employee-beneficiaries in the case before us made no purchases, transacted no business, and had no dealings whatsoever with the broker-dealer in question respecting the trust account. Indeed, they could not have any such dealings since the broker-dealer held no property belonging to any individual employee, in which such employee could trade or invest. Calculable amounts were payable to Reading's employees only in the event that, pursuant to the terms of the Plan, they became entitled thereto. The argument that, notwithstanding their complete anonymity and total incapacity to have dealings with the broker-debtor, the Reading employees were "customers" of Morgan-Kennedy stretches that term wholly beyond its limits.

Morgan, Kennedy, 533 F. 2d at 1318.

Further, the court below ignored that part of § 6(c)(2)(A)(ii) which includes as a "customer * * * any person who has deposited *cash* with the debtor for the purpose of purchasing securities. . ." (emphasis added). Because the "claim was solely for a cash credit balance . . .," 533 F. 2d at 1321, *Morgan, Kennedy* squarely decided that plan monies in the hands of the debtor were not the participants' monies; therefore a participant

is not a customer/investor.[25] This reasoning is consonant with the nature of employer contributions to a welfare plan like the Local 705 Pension Fund.

> Let us examine the nature of these contributions. They are flat sums . . . per month for each workman. The amount is without relation to his hours, wages or productivity. It is due the trustees, not the workman, and the latter has no legal interest in it whatsoever. A workman cannot even compel payment by a defaulting employer. . . .The contract here refers to them as "contributions." Finally, [the employer's] obligation is to contribute sums to the trustees, not to its workmen; it is enforceable only by the trustees who enjoy not only the sole title, but the exclusive management of the funds.

United States v. *Embassy Restaurant*, 359 U. S. 29, 32 (1959). *See also Joint Industry Board* v. *United States*, 391 U. S. 224 (1968); *Lewis* v. *Benedict Coal Corp.*, 361 U. S. 459, 465-66 (1960); *Assalone* v. *Carey*, 473 F. 2d 199, 205 (DC Cir. 1972); *cf. Lewis* v. *Quality Coal Corp.*, 243 F. 2d 769, 772-73 (7th Cir. 1957). The court below, however, ignored the true nature of the contributions and equated them with the employee's compensation[26] which he or she invests in the Local 705 Pension Fund. The jump from "compensation" to "his money" cannot be so easily done.

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25. The court below considered *Klamberg* v. *Roth*, 425 F. Supp. 440 (SD NY 1976), "[m]ore relevant" to the conclusion that the employee-beneficiary is an investor in a noncontributory mandatory pension fund (App. 222a-23a). *Klamberg*, however, concerned only whether a "beneficiary of a trust has standing to bring an action based on § 10(b) of the [1934 Act] . . . against the trustees of the trust," *id.* at 441, for "[f]raud perpetrated by a trustee *in the purchase or sale of securities*," *id.* at 443 (emphasis added); an issue neither raised below nor presented to this Court.

26. The district court equated the employer contributions with the employee's wages (App. 122a). The court below referred to the contributions as "a sector of the total employee compensation structure" (App. 223a). Nevertheless, it treated them as wages, i.e., "money . . . which he would otherwise be getting in his paycheck" (App. 224a); "his money" (App. 225a n. 20); "part of the total wage package" (App. 246a n. 41).

This Court's *dictum* that employer "payments [to a welfare fund] are really another form of compensation to the employees," *Lewis* v. *Benedict Coal Corp.*, 361 U. S. at 469, was placed in its proper perspective in *Alabama Power Co.* v. *Davis*, 431 U. S. 581 (1977). In answer to the employer's argument that "pension payments should be viewed as compensation for service rendered, like . . . vacation payments," *id.* at 582, this Court noted that calling them compensation or wages does not end the inquiry:

> It is obvious that pension payments have some resemblance to compensation for work performed. Funding a pension program is a current cost of employing potential pension recipients, as are wages. . . . The same observations, however, can be made about any benefit and therefore are of little assistance in determining whether a particular benefit recompenses labor or rewards longevity with an employer.

Id. at 592-93 (footnotes omitted). The " 'true nature' " of the pension payments from a defined benefit plan are "a reward for length of service" and not "deferred compensation for a year of actual service. . . ." *Id.* at 593.

The court below refused to follow the teachings of *Alabama Power*. First, it relied on statements by "[u]nion spokesmen" and the expressed beliefs of employees to conclude that pension payments are deferred wages (App. 243a & n. 39). Second, the court of appeals made a direct correlation between the employer contributions to the plan and the size of the employees' wages; i.e., contributions to the fund are a direct trade-off of dollars which would otherwise have gone into the employees' pockets (App. 229a, 245a; note 26 *supra*). This Court, however, has recognized that the employer's willingness to put money into a pension fund does not necessarily mean that he would have given those dollars to the employees.

> By rewarding lengthy service, a plan may reduce employee turnover and training costs and help an employer secure the benefits of a stable work force. . . . In addition, by

> providing economic security in retirement, pension plans encourage longtime employees whose working efficiency may be on the decline to retire and make way for younger workers.

Alabama Power, 431 U. S. at 594. Finally, the opinion below read *Alabama Power* as saying that "compensation" means the equivalent of deferred wages "for length of service rather than for daily services rendered . . ." (App. 247a n. 43).

Another and formidable reason why the employer contributions to the Local 705 Pension Fund are not the employee's money is the national labor policy which has committed to Local 705 exclusive authority over the negotiation of wages,[27] hours or other conditions of employment. While conceding that Local 705, as respondent's exclusive collective bargaining agent, negotiated the creation and funding of the Local 705 Pension Fund (App. 244a n.40), that fact did not, in the court of appeals' view, destroy respondent's continuing, individual, voluntary, and effective power over the amount and distribution of his wages or compensation.

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27. The court below read *Inland Steel Co.* v. *NLRB*, 170 F. 2d 247 (7th Cir. 1948), *aff'd on other grounds sub nom., Communication Workers Union* v. *Douds*, 339 U. S. 382 (1950), to say that employer contributions are "wages" under the NLRA. However, *Inland Steel* has been read to mean only "that an employee's present interest in a plan for his retirement was sufficient to make such a plan an 'other condition of employment' " under the NLRA. *Bartmess* v. *Drewrys*, 444 F. 2d 1186, 1188 (7th Cir. 1971); *cf. Alabama Power Co.* v. *Davis*, 431 U. S. at 592 n. 16; *Chemical Workers Union* v. *Pittsburgh Plate Glass Co.*, 404 U. S. 157, 159 & n. 1 (1971). However, for the purposes of this part of our argument the result is the same whether the contributions are called wages, fringe benefits or a condition of employment. Section 9(a) of the NLRA, 29 USC § 159(a), designates the majority representative as "the exclusive representative of all employees in such a unit for the purposes of collective bargaining in respect to *wages, hours of employment, or conditions of employment.*" (Emphasis added.) Section 8(a)(5) of the NLRA, 29 USC § 158(a)(5), makes it an unfair labor practice for an employer "to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9(a)." Section 8(b)(3), 29 USC § 158(b)(3), imposes a like prohibition upon the bargaining representative.

This holding undermines the national labor policy which "extinguishes the individual employee's power to order his own relations with his employer and creates a power invested in the chosen representative to act in the interests of all employees." *NLRB* v. *Allis-Chalmers Mfg. Co.*, 388 U. S. 175, 180 (1967); *H. K. Porter Co.* v. *NLRB*, 397 U. S. 99, 103 (1970). "Central to the policy of fostering collective bargaining . . . is the principle of majority rule", *Emporium Capwell Co.* v. *Western Addition Community Organization*, 420 U. S. 50, 62 (1975), which permits the union to bargain away valuable employee rights, *Allis-Chalmers*, 388 U. S. at 180. This Court has refused to fashion "a limited exception to that principle" in the vital area of the elimination of racially discriminatory employment practices. *Emporium-Capwell*, 420 U. S. at 65.

"Wages, hours, working conditions, seniority, and job security therefore became the business of certified or recognized bargaining agents * * * [whose] broad authority in negotiating and administering effective agreements is 'undoubted' " and subject only to the duty of fair representation.[28] *Hines* v. *Anchor Motor Freight Lines, Inc.*, 424 U. S. 554, 563, 564 (1976). "[P]ensions are a mandatory subject of collective bargaining under the [NLRA]" between Local 705 and the employers. *Alabama Power Co.* v. *Davis*, 431 U. S. at 592 n. 16.

The theme is repeated in § 302(c)(5)[29] of the LMRA

28. The court of appeals notwithstanding, in the context of this case the duty of fair representation does not apply to Local 705 or to the employee trustees of the Local 705 Pension Fund. *NLRB* v. *Carpenters Local 1913*, 531 F. 2d 424, 426-27 (9th Cir. 1976); *Miniard* v. *Lewis*, 387 F. 2d 864, 865 n. 5 (DC Cir. 1967); *United Marine Div.* v. *Essex Transportation Co.*, 216 F. 2d 410, 412 (3rd Cir. 1954), cited with approval by the court below in *Lewis* v. *Quality Coal Corp.*, 243 F. 2d 769, 772, 773 (7th Cir. 1957); *Morgan* v. *Laborers Pension Trust Fund*, 433 F. Supp. 518, 530 (ND CA 1977); *Sheet Metal Workers Union*, 234 NLRB No. 162 (1978). This issue is not before this Court.

29. Section 302(c)(5), 29 USC § 186(c)(5), provides as pertinent:

> (c) The provisions of this section shall not be applicable * * *;
> (5) with respect to money or other thing of value paid to a

(Footnote continued on next page.)

which was the statutory foundation for the Local 705 Pension Fund. Section 302(c)(5) excludes from the criminal proscriptions of § 302(a) employer contributions paid to a trust fund established by the employees' collective bargaining representative. Subsection (c)(5)(B) mandates that the "basis on which such payments are to be made is specified in a written agreement" between the union and the employer who "are equally represented in the administration of such fund." Thus § 302 (c)(5) says that the creation, funding, participation in, and administration of the employee benefit trust is the business of the employees' collective bargaining representative. Contrary to the court below (App. 257a), § 302 is not a broad disclosure statute. Thus whether employer contributions to the Local 705 Pension Fund and like plans are labeled as employee "wages" or "compensation" or an other condition of employment, § 302(c)(5) of the LMRA and §§ 8(a)(5), 8(b)(3), and 9(a) of the NLRA make their creation, amount, nature, and continuation the exclusive function of Local 705 and other certified or recognized unions.

The court of appeals, however, abrogated the principle of *collective* bargaining by holding that the individual employee, not his or her statutory representative, retains unfettered authority over a mandatory subject for bargaining under the NLRA and a function committed to the union by § 302(c)(5). Under the court of appeals' construct, the recognized or certified union

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> trust fund established by such representative, for the sole and exclusive benefit of the employees of such employer, and their families and dependents . . .: *Provided,* That (A) such payments are held in trust for the purpose of paying, either from principal or income or both, . . . pensions on retirement or death of employees * * *; (B) the detailed basis on which such payments are to be made is specified in a written agreement with the employer, and employees and employers are equally represented in the administration of such fund * * *; and (C) such payments as are intended to be used for the purpose of providing pensions or annuities for employees are made to a separate trust which provides that the funds held therein cannot be used for any purpose other than paying such pensions or annuities * * *.

is no longer the *exclusive* representative of all the employees as mandated by § 9(a). The court of appeals' new principle cannot be restricted to the subject of employer contributions to employee pension plans. Either the national labor policy, as embodied in the labor statutes and this Court's decisions, commits to the employees' designated representative *exclusive* bargaining authority over § 9(a) subjects or it does not. The court of appeals says that it does not. One result of this abrogation of the national labor policy is the potentiality for embroiling the federal courts in extensive litigation,[30] *cf. Buffalo Forge Co.* v. *Steelworkers Union,* 428 U. S. 397, 411 n. 12 (1976), while diminishing the voluntary adjustment policies in §§ 203(d) and 204(a) of the LMRA, 29 USC §§ 173(d) and 174(a).

2. Profits and Profit Motivation Are Missing in the Pension Transaction.

Using the parlance of the capital market the court of appeals said that the employee's expected profit would be the difference between his or her cost of participation in the pension plan and the expected pension benefit[31] (App. 226a). The errors in this analysis are that employer contributions are the employer's actuarially determined cost of maintaining the pension plan

30. Further litigation under the securities acts is engendered even if the court of appeals' decision is restricted to employer contributions to § 302(c) plans. These plans, via subsection (A), encompass trusts to pay employee and dependents "medical or hospital care . . . compensation for injuries or illness resulting from occupational activity . . . or unemployment benefits or life insurance, disability and sickness insurance, or accident insurance;" via subsection (6) to pay "pooled vacation, holiday, severance or similar benefits" or apprenticeship or other training programs; and by sub-sections (7) and (8) to pay for scholarships, child care centers and group legal services. Each of the trusts, by virtue of § 302(c)(5), will be structured and funded in whole or in part as is the Local 705 Pension Fund. Thus, it may be that all § 302(c) plans are subject to the securities acts principles stated by the court below. *Cf. Inland Steel Co.* v. *NLRB,* 170 F. 2d at 249.

31. Rather than a function of investment return (App. 277a), the Local 705 Pension Fund promised pension benefit is derived primarily from increased employer contributions and participant turnover (A6-A7 *infra*).

rather than the employee's cost, and that the employee is not attracted to the plan by the expectation of profits.

In a noncontributory defined benefit plan the employee has no interest in the contributions to make them the employee's cost. Prior to vesting the employee has no right either to the contributions or to a pension benefit. After vesting the only right is an enforceable contractual right to the promised pension but not to the contributions. The opinion below converted the Local 705 Pension Fund from a defined benefit plan[32] to a defined contribution plan.[33]

The court of appeals, based on respondent's affidavit, said that respondent's decision to take and keep covered employment was predicated upon his desire for a pension. The affidavit stated that respondent believed in 1975 that had he known over his career in covered employment about the Local 705 Pension Fund what he knew then, that he would have given up his job —including seniority, wage increments, hospitalization, fringes, and working conditions—obtained retraining, if necessary, and looked elsewhere for work (App. 245a). By relying on respondent's subjective *ex post facto* affidavit, the opinion below became a testimonial to the vexatious nature of this litigation; i.e., the court

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32. ERISA, § 3, 29 USC § 1002, provides as pertinent:

> (35) the term "defined benefit plan" means a pension plan other than an individual account plan; * * *.

"Under a defined benefit plan, a participant's accrued benefit is his accrued benefit determined under the plan." Treas. Reg. § 1.411(b)-1(a)(1) (1978).

33. ERISA, § 3 also provides:

> (34) the term "individual account plan" or "defined contribution plan" means a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

"Under a defined contribution plan, a participant's accrued benefit is the balance to the credit of the participant's account." Treas. Reg. § 1.411(b)-1(a)(1) (1978).

> would throw open to the trier of fact many rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony. We in no way disparage the worth and frequent high value of oral testimony when we say that dangers of its abuse appear to exist in this type of action to a peculiarily high degree.

Blue Chip Stamps v. *Manor Drug Stores*, 421 U. S. 723, 743 (1975).

Nevertheless, the employee's claimed motivation for participating in the Local 705 Pension Fund cannot be characterized as expectation of profits. Should a participant retain a job at least in part because of the prospect of a secure retirement income, that preference is not "either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of the investors' funds. . . ." *Forman*, 421 U. S. at 852. The participant's potential for exchanging a better job opportunity elsewhere for the promise of a pension if and when the participant is vested is "an inappropriate theory of 'profits' that we cannot accept." *Id.* at 855.

To form an investment contract the attraction to the enterprise must be the expectation of substantial profits. *Howey*, 328 U. S. at 296. That attraction is absent in the Local 705 Pension Fund and other mandatory noncontributory pension plans which—like cooperative and condominium housing arrangements—are not rivals to variable annuities, mutual funds or any of the other "countless and variable schemes devised by those who seek the use of money of others on the promise of profits." *Id.* at 298.

3. A Participant Has No Shares or Other Evidence of an Interest in the Local 705 Pension Fund Assets.

A nonvested participant in the Local 705 Pension Fund has no certificate of participating interest, no shares and no evidence of an interest in the fund assets (App. 220a n. 15). Accordingly, we need not belabor the point that respondent had not the tangible or intangible interest in the fund required by *Howey*.

In summary then, the Local 705 Pension Fund is a product of the national labor policy and regulated by the labor statutes. As a tax exempt not-for-profit trust created for the purpose of providing retirement benefits to covered employees and their dependents, it is not part of the profit-making capital market and possesses none of "the characteristics 'that in our commercial world fall within the ordinary concept of a security.'" *Forman*, 421 U. S. at 847-48.

II.

THERE WAS NO SALE BY THE LOCAL 705 PENSION FUND TO OR PURCHASE BY RESPONDENT.

A sale requires the disposition of a security for value between a seller and a purchaser. No sale occurred in this case because the Local 705 Pension Fund was not the seller and because employee volition is missing. The court of appeals found that respondent made a disposition for value to his employer in the form of his services and that the employer's contributions were the *quid pro quo* for those services. Under that construct, however, the employer, not the Local 705 Pension Fund, is the purchaser and the employee is the seller.[34]

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34. The cases cited by the court below (App. 243a-44a) on this point were employer-employee situations. *Collins* v. *Rukin*, 342 F. Supp. 1282 (Mass. 1972), and *SEC* v. *Addison*, 194 F. Supp. 709 (ND Tex. 1961), involved employers who induced employment on the promise of profits from the scheme. *Laurence* v. *SEC*, 398 F. 2d 276 (1st Cir. 1968), involved a broker and a customer and discusses *Addison* in *dictum*, *id.* at 280. *Hector* v. *Wiens*, 533 F. 2d 429 (9th Cir. 1976), is inapposite, involving a financing arrangement among a grain farmer, a feedlot and a bank. The court held only that the plaintiff had invested his money because "plaintiff was still liable on the note and subject to financial loss," *id.* at 431-32. The Commission cases, *Oklahoma Nat. Gas. Co.*, 1971-72 Cas. Fed. Sec. L. Rep. (CCH) ¶ 78,583 (1971); *Allis-Chalmers Corp.*, 1972-73 Cas. Fed. Sec. L. Rep. (CCH) ¶ 78,803 (1972); *Keene Corp.*, 1971-72 Cas. Fed. Sec. L. Rep. (CCH) ¶ 78,475 (1971); *Missouri Research Laboratories, Inc.*, 1972-73 Cas. Fed. Sec. L. Rep. (CCH) ¶ 79,036 (1972), involved employer sponsored employee bonus and incentive plans. The Commission concluded that " 'value' will

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The Commission historically recognized that volition is a component of a sale when it held that there is no sale to the employee in a mandatory noncontributory pension plan.[35] This

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pass to [*the employer*] in the sense that Participants will be induced to continue their employment with [the employer] from which [the employer] will derive substantial benefits." *Oklahoma Nat. Gas Co., supra,* at 81,252 (emphasis added). The opinions concerned the need to register shares of employer stock to be used as part of the benefit payout, an issue which is irrelevant here. *SEC* v. *Harwyn Industries,* 326 F. Supp. 943 (SD NY 1971), concerned the application of the registration provisions to the shares of a subsidiary corporation formed by a corporate spinoff. *Pete* v. *Mineworkers Union,* 517 F. 2d 1275 (DC Cir. 1976), intepreted § 302(c)(5) of the LMRA and held that pensions were properly denied miners with less than five years of service, *id.* at 1287.

35. The court below incorrectly characterized the Commission's position as based on the absence of a "direct investment of money by the employee" and as applying only to the acts' registration provisions (App. 245a). As to the first point, the Commission's words are the best proof that it relied on the lack of employee volition.

> Although the employees' interests in the plan (whether the plan's assets are invested through a funding medium or consists solely of an obligation of the employer recoverable from the general assets of the employer) may be recognized to be "securities" within the Act, *the absence of a volitional element* on the part of the employees in acquiring these interests is the basis for the position. While this result may not be compelled by the statutory definition of "sale", the result is consistent with the basic scheme of the Act to provide would-be purchasers with information adequate to make an informed opinion as to whether to purchase—assuming that there is a real difference between employer and employee contributions.

Securities and Exchange Commission Institutional Investor Study (1971) at 996.

Before the brief to the court below, there is nothing in the Commission's statements which would have lead a reasonable person to the judgment that the "no sale" position applied only to the acts' registration provisions. In fact the 1971 Study said that "the Commission staff has taken the position that the Securities Act does not apply because there is no 'sale' or 'offer for sale'. . ." (at 996)—not the registration provisions, not the antifraud sections, not rule 10b-5, but "the Securities Act." The court of appeals gave inappropriate deference to the Commission's novel and strained interpretation in the face of

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reasoning is consonant with the provision of the collective bargaining contract which mandates employee plan participation and the doctrines of majority representation and majority rule which negate individual volition. The court below found the requisite individual volition to enter or remain in the plan in the union procedure whereby employees can ratify or reject the negotiated collective agreement. Under that postulate a sale would occur only in a plan created and maintained by collective bargaining, and then only where the union requires ratification of the contract.[36] There would be no volition and thereby no sale in the context of employer sponsored noncontributory plans and collectively bargained plans where there is no union ratification procedure. This desultory approach to antifraud coverage is unacceptable.[37]

The union's elimination of contract ratification to avoid the impact of the securities acts on the negotiated plan does not

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what everyone, including Judge Tone, thought the Commission had said. *Compare United States* v. *Nat. Ass'n of Securities Dealers,* 442 U. S. 694, 717-18 (1975); *Chemehuevi Tribe* v. *FPC,* 420 U. S. 395,408 (1975); *SEC* v. *New England Electric System,* 384 U. S. 176,185 (1966) (applying the administrative deference rule to an agency's tenured interpretation) *with Santa Fe Industries, Inc.* v. *Green,* 430 U. S. 462, 473 n. 12 (1977); *Piper* v. *Chris-Craft Industries,* 430 U. S. 1, 41 n. 27 (1977); *Forman,* 421 U. S. at 858 n. 25 (Commission's current position not entitled to judicial weight).

36. If the employer desired to negate employee volition and thereby a sale through the expedient method of having the ratification process eliminated, he is powerless to do so absent union consent. An employer's insistence is an unfair labor practice. *See Houchens Market* v. *NLRB,* 375 F. 2d 208,212 (6th Cir. 1967).

37. As a further back up position the court below said that volition is found in the employee's choice of jobs based on the employer's pension plan (App. 244a n. 40). The argument is premised on respondent's affidavit and a law review note. The problem with the affidavit is discussed *supra* at 53-54. The portion of the article relied upon discussed pension plans which are not part of a trust, Note, 70 Harv. L. Rev. 490, 493 (1957), noting that where the trust exists, as in the case of the Local 705 Pension Fund, "the interest of the employee is of the same nature as the interest of an ordinary beneficiary", *ibid.*

The court of appeals accepted the Commission's contention that its present assertion of coverage is not inconsistent with its prior interpretation of the securities laws. The historic record unmistakably refutes that position. The most important evidence of the prior and contrary understanding consists of the Commission's disclaimers of jurisdiction during the hearings and debates over the WPPDA and ERISA and its total failure to exercise the regulatory authority which it told the court below it always had and always thought it had.

We turn now to a review of the *Howey* criteria for an investment contract in light of the economic realities principle.

D. The Howey Criteria Are Not Applicable to the Local 705 Pension Fund.

Respondent did not plead an investment contract theory. Rather, his claim was that he had a "participating interest" in the Local 705 Pension Fund (App. 29a, Complt. ¶ 12). The court below changed his theory (App. 220a n. 15).

An investment contract is

> a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

Howey, 328 U. S. at 298-99. As a matter of economic reality respondent did not "invest his money" in, was not "led to expect profits" from, and had no "shares" in the Local 705 Pension Fund "evidenced by formal certificates or by nominal interests" in the fund assets.

1. Employer Contributions to a Noncontributory Pension Trust Are Not the Employee's Money Which He or She Invests.

Howey requires that the individual be an investor, i.e., a person who invests his or her money in the common enterprise. The inquiry therefore is whether employer contributions are the

participant's money which he or she invests in the Local 705 Pension Fund. In interpreting the Securities Investor Protection Act of 1970 (SIPA), 15 USC §§ 78aaa *et seq.*, a member of the family of securities laws, the Second Circuit held that employee-beneficiaries of a noncontributory profit sharing plan were not "customers"[24] of a bankrupt broker-dealer. *SIPC* v. *Morgan, Kennedy & Co.*, 533 F. 2d 1314 (2nd Cir. 1976), *cert. denied*, 426 U. S. 936 (1976). "Customer" in SIPA and "investor" under the securities acts are synonymous words of art. *Id.* at 1317 & n. 5; *see Massachusetts Financial Services, Inc.* v. *SIPC*, 545 F. 2d 754, 756 n. 3 (1st Cir. 1976), *cert. denied*, 431 U. S. 904 (1977).

The court below distinguished *Morgan, Kennedy* on the ground that SIPA's definition of "customer" was " 'persons who have claims on account of securities *received, acquired* or *held* by the debtor from or for the *account of such persons*' "; that the account and the securities were purchased in the trust name; and that "[b]ecause of the *sui generis* definition of customer/investor under [SIPA], *Morgan, Kennedy* is irrelevant to the question whether the union members have made an investment in [sic] the meaning of the 1933 and 1934 Acts" (App. 222a). We do not perceive the court's point. If the money which purchased the securities were the employee's money, then the securities bought by the plan would in economic reality be held by the debtor for "the account of such persons" albeit the formal name on the account is that of the plan trustees. The securities held by the debtor are not held "on account of"

24. As pertinent, § 6(c)(2)(A)(ii) of SIPA, 15 USC § 78fff(c)(2)(A)(ii), provides:

> "customers" of a debtor means persons (including persons with whom the debtor deals as principal or agent) who have claims on account of securities received, acquired, or held by the debtor from or for the account of such persons • • •, and shall include persons who have claims against the debtor arising out of sales or conversions of such securities, and shall include any person who has deposited cash with the debtor for the purpose of purchasing securities • • •.

(the registration provision), are the only provisions of the 1933 Act which provide for civil remedies. Section 12 expressly prescribes the remedy of rescission,[41] and § 13 describes the limitations period for suits brought under §§ 11 and 12.[42] Section 17(a) on its face creates no private right of action. On the contrary, injunctive relief at the behest of the Commission under § 20 and criminal prosecution pursuant to § 24 are the means established by Congress to remedy a violation of this section.

Nothing in the legislative history of the 1933 Act even remotely suggests that Congress intended investors to have a cause of action for civil liability found upon § 17(a). The House Committee Report pointed only to §§ 11 and 12 when it listed the sections that "define the civil liabilities imposed by the Act." H. R. Rep. No. 85, 73d Cong., 1st Sess. 9-10 (1933). Contemporaneous commentators found no basis for implying civil liabilities for violation of § 17. In November 1933 Commissioner Landis of the Federal Trade Commission, who had played a prominent role in drafting the statute which the FTC originally enforced, stated:

> The suggestion has been made on occasion that civil liabilities arise from a violation of Section 17 . . . But a read-

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41. Section 12, 15 USC § 77l, allows a plaintiff to sue "to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

42. Section 13, 15 USC § 77m, states:

> "No action shall be maintained to enforce any liability created under section 77k or 77l(2) [section 11 or 12(2)] of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77l(1) [section 12(1)] of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77l(1), [section 11 or 12(1)] of this title more than three years after the security was bonda fide offered to the public, or under section 77l(2) [section 12(2)] of this title more than three years after the sale."

> ing of this section in the light of the entire Act leaves no doubt but that violation of its provisions give rise only to a liability to be restrained by injunction action or, if wilfully done, to a liability to be punished criminally.

Landis, *Liability Sections of Securities Act Authoritatively Discussed*, 18 Am. Accountant 330, 331 (1933). An article co-authored by then Professor William O. Douglas stated: "Section 17 probably does not enlarge civil remedies of purchasers. This seems clear by negative implication since Sections 11 and 12 expressly state the remedies which are available." Douglas & Bates, *The Federal Securities Act of 1933*, 43 Yale L. J. 171, 181-82 (1933). Professor Harry Shulman, in a 26-page article, entitled "Civil Liability and the Securities Act" did not even mention § 17. 43 Yale L. J. 227 (1933). So too, Professor Loss found no reason to "add an implied remedy under § 17(a) of the 1933 Act to the detailed remedies specifically created by §§ 11 and 12." 3 Loss, Securities Regulation 1785 (2d ed. 1961). In sum,

> there is unanimity among the commentators, including some who were in a particularly good position to know, that § 17(a)(2) of the 1933 Act—indeed, the whole of § 17—was intended only to afford a basis for injunctive relief and, on a proper showing, for criminal liability, and was never believed to supplement the actions for damages provided by § 11 and 12.[43]

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43. *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 867 (2nd Cir. 1968) (Friendly, J. concurring), *cert. denied*, 394 U. S. 976 (1969). The court below mistakenly cited *Globus* v. *Law Research Service, Inc.*, 418 F. 2d 1276 (2nd Cir. 1969) *cert. denied*, 397 U. S. 913 (1970), "as having decided [that] there was a cause of action under Section 17(a) because there was 'little practical point in denying the existence of an action under Section 17 once it is established that an aggrieved buyer has a private action under Section 10(b) of the 1934 Act' " (App. 249a n. 45). While the *Globus* opinion did cite "many authorities upholding a private right of action for a violation of Section 17(a)" (App. 249a n. 45), it also observed, "But even today there lingers some unhappiness with this principle." 418 F. 2d at 1283. Judge Kaufman stated: "Since we affirm only the award of compensatory damages, which could stand either on the basis of § 10(b) of the 1934 Act or § 17(a), we need not tarry over whether § 17(a) standing alone would support an action for compensatory damages." *Ibid.* Thus, the question is plainly open in the Second Circuit.

The Securities and Exchange Commission appeared to agree. In 1941 testimony before the Congress in connection with proposed amendments to the Securities Act of 1933, Commissioner Purcell stated flatly: "Under the statute there are no civil liabilities which attach to violations of Section 17."[44]

While, as noted, the issue of a remedy under § 17(a) was reserved in *Blue Chip Stamps*, what this Court did say about civil remedies under the 1933 Act is very much in point and accords with the views of the commentators we have quoted:

> Sections 11 and 12 of the 1933 Act provide express civil remedies for misrepresentations and omissions in registration statements and prospectuses filed under the Act, as here charged, but restrict recovery to the offering price of shares actually purchased:
>
> > "To impose a greater responsibility, apart from constitutional doubts, would unnecessarily restrain the conscientious administration of honest business with no compensating advantage to the public." H. R. Rep. No. 85, *supra*, at 9.
>
> And in Title II of the 1934 Act, 48 Stat. 905-908, the same Act adopting § 10(b), Congress amended § 11 of the 1933 Act to limit still further the express civil remedy it conferred. See generally James, Amendments to the Securities Act of 1933, 32 Mich. L. Rev. 1130, 1134 (1934). The

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44. 1941 Hearings at 806. And in a brief filed by it in 1943, the Commission asserted:

> "There are three such provisions. Section 11 (15 USC § 77k) imposes civil liabilities for false statements in registration statements. It is inapplicable to nonregistered securities, and hence is inapplicable here. Section 12(1) imposes civil liability upon any person who sells unregistered securities in violation of Section 5. Section 12(2) imposes such liability upon any person who sells securities through the mails or in interstate commerce by means of misrepresentations or material omissions of fact."

Brief of the Securities and Exchange Commission as *Amicus Curiae*, *The National Supply Company* v. *Leland Stanford Junior University*, (9th Cir. No. 10272). But the Commission took the opposite view in *Blackwell* v. *Bentsen*, 203 F. 2d 690 (5th Cir. 1953), *cert. denied*, 347 U. S. 925 (1954), Brief for SEC, No. 14127, pp. 75-78, as described in 3 Loss, Securities Regulation 1787 (2d ed. 1961).

> additional congressional restrictions, contained in Title II of the 1934 Act, on the already limited express civil remedies provided by the 1933 Act for misrepresentations or omissions in a registration statement or prospectus reflected congressional concern over the impact of even these limited remedies on the new issues market. 78 Cong. Rec. 8668-8669 (1934).

421 U. S. at 753-54.

Congress made its intention so clear that it would be plainly inappropriate for the courts to imply an additional civil remedy under § 17(a).

CONCLUSION

Petitioners request that this Court reverse the judgment of the court below with directions that counts I and II of the amended complaint be dismissed.

Respectfully submitted,

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Attorney for Petitioners.

AFFIDAVIT
For
LOCAL 705 PENSION FUND
vs.
DANIEL

SUPREME COURT OF THE UNITED STATES
No. 77-754

Richard I. Citron, Enrolled Actuary Number 2303, being first duly sworn says:

I am a consulting principal with A. S. Hansen, Inc. and I have participated in and supervised the preparation of this affidavit. I have been assisted in the preparation by: Mr. Richard C. Keating, Enrolled Actuary Number 2245, who is chairman of the A. S. Hansen, Inc. Executive Committee, Chairman of the A. S. Hansen, Inc. Actuarial Committee, a member of the American Academy of Actuaries, and a Fellow of the Conference of Actuaries in Public Practice; Mr. Donald I. Brothers, Certified Public Accountant, who is a consulting principal with A. S. Hansen, Inc., and formerly President and Chief Executive Officer of Administration/Systems/Communications, Inc. The facts contained in this affidavit were derived from A. S. Hansen's books and records as kept in the ordinary course of business and those of the Local 705 I. B. and T. Pension Fund publications, plus other documents, and are true to the best of my knowledge and belief.

INFORMATION CONCERNING A. S. HANSEN, INC.

A. S. Hansen was founded in 1930 and now serves about 2,500 clients nationally. These clients represent various state public retirement systems, local governmental units, large and small corporations, labor organizations and jointly-managed

trust funds. We employ over 450 people who possess a broad spectrum of professional and academic credentials and who serve as resources with respect to all areas of employee benefits. The current status of A. S. Hansen employees with respect to professional actuarial associations is as follows:

Society of Actuaries: 9 Fellows and 28 Associates

American Academy of Actuaries: 21 Members, 26 Affiliates

Conference of Actuaries in Public Practice: 8 Fellows, 5 Members and 1 Associate

Canadian Institute of Actuaries: 2 Fellows, 1 Associate

Fraternal Actuarial Association: 1 Fellow

Further, we have at least 50 individuals who are Enrolled Actuaries and are able to certify actuarial calculations per the requirements of ERISA.

Our firm offers a single source of comprehensive, impartial actuarial counsel on pension and welfare programs, and a broad range of technical services, on a professional fee basis. Our total income is obtained directly from the Companies, Funds and Associations for which we work. We are a completely independent firm without ties to any organization. From our inception, we have neither accepted nor paid commissions of any kind.

We believe that our function as consultants to joint labor-management funds is to coordinate our skills with those of the fund legal counsel, the fund administrator, and the auditor, in total support of the Trustees. We will not accept an assignment as a fund administrator. We view our work with joint funds as an important part of our total activity, and are committed to a program of support and service to Trustees throughout the country.

A. S. Hansen's national offices and its international affiliates are located in:

Atlanta, Georgia; Chicago, Illinois; Columbus, Georgia; Dallas, Texas; Denver, Colorado; Fort Worth, Texas; Houston, Texas; Lake Bluff, Illinois; Los Angeles, California; Memphis, Tennessee; Milwaukee, Wisconsin; Montgomery, Alabama; New Orleans, Louisiana; New York, New York; North Haledon, New Jersey; San Francisco, California; Tampa, Florida; Tulsa, Oklahoma; Washington, D. C.; Wellesley, Massachusetts; Wichita, Kansas; Mexico City, Mexico; Toronto, Canada; Birmingham, England; Brussels, Belgium; Chichester, England; Dublin, Ireland; Frankfurt, Germany; Glasgow, Scotland; Johannesburg, South Africa; Leeds, England; Leicester, England; London, England; Manchester, England; Melbourne, Australia.

PURPOSE

This affidavit was requested by Sherman Carmell, attorney for the Local 705 International Brotherhood of Teamsters Pension Trust Fund, in light of the decision of the United States Court of Appeals for the Seventh Circuit in *Daniel* v. *Local 705 Pension Fund* where the court characterized the potential liabilities to pension funds as "the parades of horribles", and stated:

> There should be no undue burden caused by the type of disclosure the anti-fraud provisions [of the Securities Acts] would encourage because all of the material information will readily be available to the plan trustees since their actuaries needed all of the information in order to set up the plan in the first place.

The court has stated that it will "require [a pension fund], when offering a defined [benefit] plan to a member, to disclose the actuarial probability . . . that a member will actually receive pension benefits, and factors such as risk of loss, breaks in service, death before retirement age, and plan termination . . .".

The information regarding each participant apparently required to be disclosed is not the type of information which a plan actuary uses. As will be discussed in a later section of this affidavit, actuarial calculations are made on the basis of experience and statistical expectations of a given group of people, not on the basis of any one member of the group. The overall actuarial probability relates to the expected percentage of members of a given group who will obtain benefits under various conditions required by plan provisions. The probability of any one member of this given group receiving a benefit relates to many personal factors outside of the actuarial considerations of the given group such as career aspirations, job performance, personal health, financial position, employer-employee relationships, other opportunities, etc.

Mr. Carmell has requested that we assume that the information apparently required by the court was not made available; that therefore, there is liability under the Securities Acts of 1933 and 1934; and that the measure of damages to each assumed defrauded past and present participant is the value of the contributions made by his or her contributing employer under the terms of the collective bargaining agreements in effect during the participant's period of plan participation or immediate and full vesting in the benefit earned to date (accrued benefit) at the time of termination.

This affidavit will estimate the actuarial impact of the damages discussed above on the Local 705 Pension Fund. No available data concerning this pension program could provide accurate answers concerning the potential impact of the award of damages. It was necessary to make a number of assumptions and estimates on certain groups of prior and present plan participants to arrive at an estimated liability. The assumptions, methods and groups of participants are discussed in the Appendix.

Before presenting the results of our calculations, a detailed description of the operations and dynamics of the Local 705 Pension Fund is discussed in the following material.

LOCAL 705 PENSION FUND

A. S. Hansen's Relation to the Local 705 Pension Fund

A. S. Hansen, Inc. and an acquired firm have been performing actuarial services for the Local 705 Pension Fund for all years since the Fund's inception, including those actuarial studies for the original development of the Fund's Pension Plan. As actuaries and consultants, it has been A. S. Hansen's opportunity, as professional advisor to the Trustees, to participate in the review of the total operation of the Fund since it began.

We at Hansen have found that for as long as we have been providing actuarial services, the Fund has met all standards of sound financial adequacy as actuarially determined and required throughout the years.

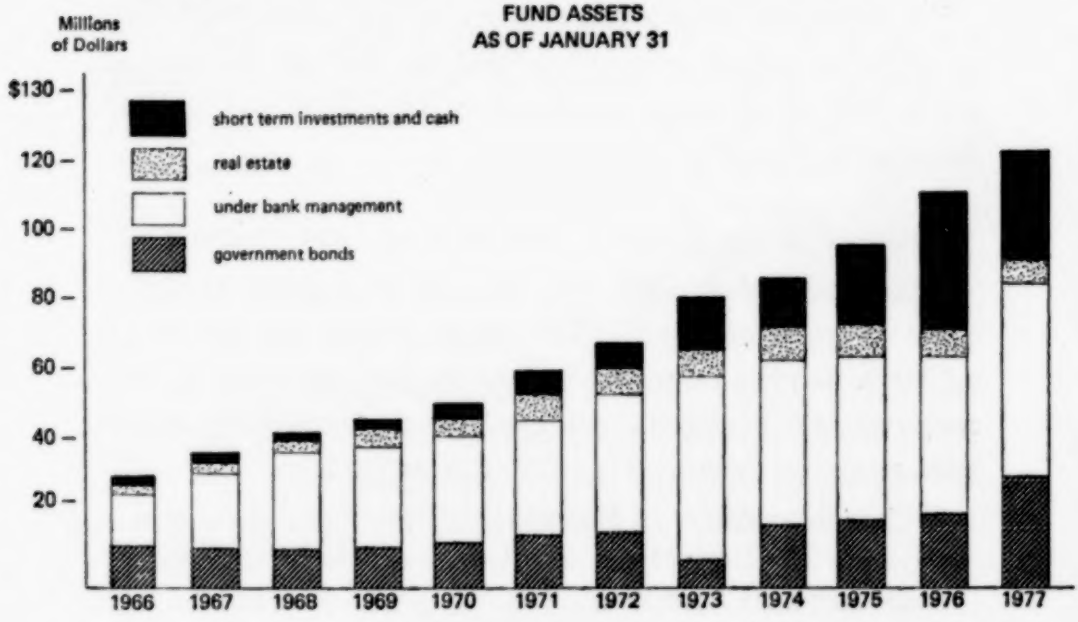
Financial Status of Local 705 Pension Fund Operations

The Local 705 Pension Fund had, as of January 31, 1977, assets of approximately $122.5 million at book value—$123.0 million at market value. The assets are and always have been conservatively managed. An approximate breakdown of the asset mix as of January 31, 1977, was as follows:

Cash, Certificates of Deposit and Receivables	$31.0 million
Government Securities	25.3 million
Discretionary Trust Funds Invested by Major Chicago Banks	60.4 million
Real Estate	5.8 million

It has been the policy of the Fund, since its inception, to invest either in government or short-term securities on a self-administered basis, with a prudent addition of real estate limited to not more than 10 percent of the portfolio. All other funds have been invested by the trust departments of major Chicago banks. Local 705 Pension Fund investment policy practices, in our opinion, anticipated the prudent man fiduciary responsibilities as defined under the Pension Reform Act (ERISA). The Trustees receive from A. S. Hansen information which gives them a full understanding of payout requirements as well as the mix of obligations between active and retired members.

The following chart illustrates the growth of the Fund and investment mix since 1966. Prior to 1966, the Fund was invested exclusively in government securities and short-term investments.



Operating Results

For the fiscal year ending January 31, 1977, employers contributed approximately $18.0 million to the Fund on behalf of Fund members. In addition, during the fiscal year the Fund

received some $6.8 million in investment income on approximately $122 million in Fund assets. Benefit payments to retirees were approximately $12.3 million for the year. Administrative expenses amounted to $584,000 or only 3.2 percent of the contributions received. Administrative expenses represent the fund office administrative costs, data processing support, and all investment and professional fees including support from the auditor, the legal counsel, and the actuary.

The annual audit report as of January 31, 1977, provides an exhibit consolidating all revenue and expenditures from the inception of the Fund in February, 1955, through January 31, 1977. From the inception some $153 million in contributions have been received from employers participating in the Fund; $7.5 million have been transferred from other smaller funds which have merged with the Local 705 Pension Fund over the years; investment income has totalled $31 million; and retired members and beneficiaries have received $65 million in benefits. The cumulative administrative cost as a percent of contributions received has been 2.25 percent for the entire period of the Fund's operation. The cumulative average for the administrative cost has been lower overall than for the year ending January 31, 1977, because of the additional costs due to ERISA.

In Hansen's experience as actuaries for a number of multi-employer funds and also based on government statistics published by the Department of Labor, the cumulative administrative costs as a percent of contributions for the operation of this Fund have been less than half the average for funds of this size. Smaller funds experience an even higher percent of administrative costs as related to contributions.

The following chart illustrates the financial operation of the Fund since 1966:

further the concept of union democracy most recently embodied in the Labor-Management Reporting and Disclosure Act of 1959 (LMRDA), 29 USC §§ 401 *et seq.*, *cf. NLRB* v. *Allis-Chalmers*, 388 U. S. at 195 (Congress concerned with "arbitrary and undemocratic leadership"), a point not considered serious by the court below (App. 244a n. 40). The court makes an inapt comparison between a union's ratification process and a shareholder's vote on a corporate merger. In the union ratification process an individual's opposition to the plan is ineffective once the majority has acted to the contrary. Therefore the union member's vote to accept a collectively bargained agreement is cast in an entirely different statutory environment than the shareholder's vote to approve a corporate merger. Whereas the shareholder votes as a matter of right under state corporation law, the ratification process is a matter for intra-union discretion. Moreover, unlike the dissenting shareholder, the out voted employee cannot opt out of the agreement and receive a cash payment.

III.

THERE IS NO IMPLIED PRIVATE CAUSE OF ACTION FOR VIOLATION OF SECTION 17(a) OF THE SECURITIES ACT OF 1933.

In addition to his claim under § 10(b) of the 1934 Act (and rule 10b-5) respondent asserts a private cause of action under § 17(a) of the 1933 Act; an issue reserved in *Blue Chip Stamps*, 421 U. S. at 733 n. 6. The court of appeals held that it does, following its own prior decisions,[38] which are, however, contrary to those of the Sixth and Eighth Circuits.[39] The court

38. See *Surovitz* v. *Hilton Hotels Corp.*, 342 F. 2d 596, 604 (7th Cir. 1965), *reversed on other grounds*, 383 U. S. 363 (1965); *Schaeffer* v. *First National Bank of Lincolnwood*, 509 F. 2d 1287, 1293 (7th Cir. 1975).

39. *Shull* v. *Dain, Kalman & Quail, Inc.*, 561 F. 2d 152, 159 (8th Cir. 1977), *cert. denied*, 46 USLW 3527 (Feb. 21, 1978); *Greater Iowa Corp.* v. *McLendon*, 378 F. 2d 788-90 (8th Cir.

(Footnote continued on next page.)

of appeals' reasoning is simply that because a claim is stated under § 10(b) " 'there seems to be little practical value in denying the existence of a private action under § 17 . . .' " (App. 248a). This "why not" analysis shows little judicial reasoning or attention to this Court's critical discussion of the rise and expansion of rule 10b-5 litigation. *Blue Chip Stamps*, 421 U. S. at 729-30.

> When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn. Such growth may be quite consistent with the congressional enactment and with the role of the federal judiciary interpreting it, . . . but it would be disingenuous to suggest that either Congress in 1934 or the Securities Exchange Commission in 1942 foreordained the present state of the law with respect to Rule 10b-5.

Id. at 737. The structure of the 1933 Act, its legislative history and the contemporaneous understanding all demonstrate that Congress focused on the issue of private civil remedies when it passed the 1933 Act, and chose to provide them for some violations of provisions of the Act but not for violations of § 17(a).

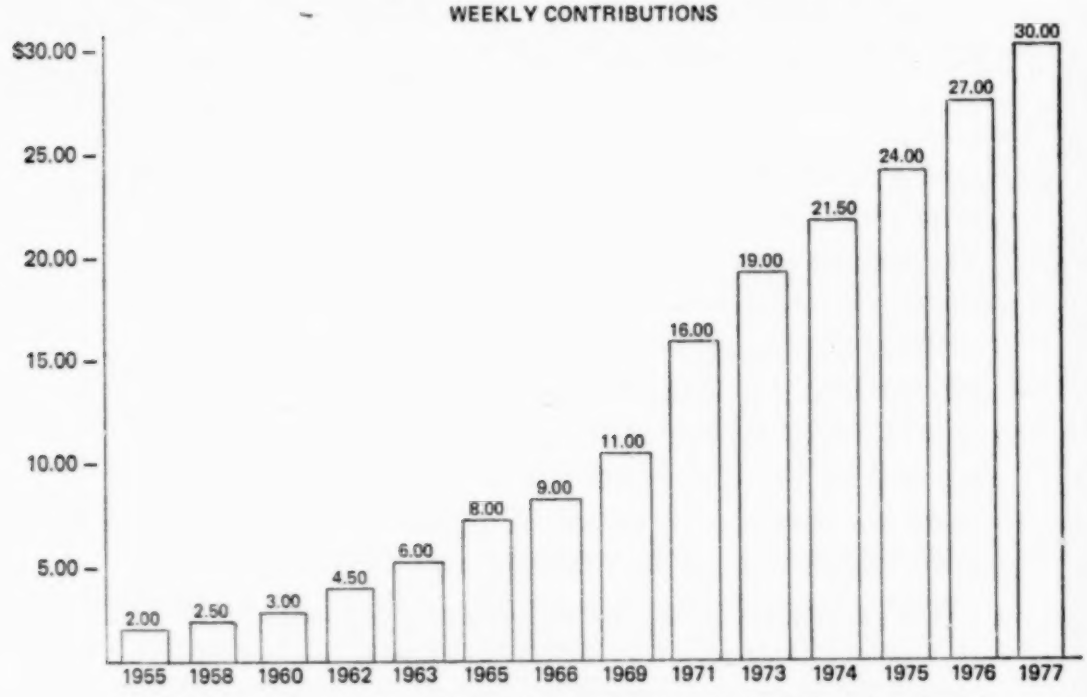
Section 12(2) provides an express remedy to one who purchases a security sold by means of a materially untrue or misleading prospectus[40] or oral communication. This provision, together with § 11, which provides an express remedy for one who purchases based upon a materially untrue or misleading registration statement, and § 12(1), which provides an express remedy to one who purchases a security sold in violation of § 5

(Footnote continued from preceding page.)
1967); *Simmons* v. *Wolfson*, 428 F. 2d 455, 456 (6th Cir. 1970), *cert. denied*, 400 U. S. 999 (1971). Countless district courts have ruled on the question, going both ways. See, e.g., cases collected in *Gunter* v. *Hutcheson*, 433 F. Supp. 42, 44 (ND Ga. 1977).

40. A "prospectus" is defined as including virtually any form of written or broadcast communication which offers a security for sale. § 2(10), 1933 Act.

Contribution And Benefit Changes

The Fund began in 1955 on the basis of a $2.00 per week employer contribution for each covered member. From the beginning, the amount of benefits available has been determined on the basis of actuarial valuations using census data of the active and retired members of the Fund and considering assets and future expected employer contributions. The following chart graphically illustrates the increases in weekly employer contributions for the majority of members as negotiated under collective bargaining agreements between the employers and the Union. Some variations do exist in contributions, particularly for groups which have been merged into the Fund in recent years.



With the increased contributions, the Local 705 Pension Fund was able to make these benefit improvements:

1955

Fund began. Pensions of $75 a month paid after age 65 and the required 20 years of service.

1960

Monthly pensions increased to $100. Previous retirees' pension also increased to $100.

1962

Age at which full benefit would be payable was reduced to 62.

1963

Monthly pensions increased to $150 for first five years. Disability pensions paid after age 55 and 15 continuous years of service. Survivors' lump sum benefit of $1,000 established.

1965

Pensions increased to $250 a month for first five years, followed by $150 a month for life. Previous retirees' pension increased to $150 a month.

1966

Retirement age reduced to 57. Disability retirement age reduced to 45. Pension payments continued to a surviving spouse until 120 monthly payments in all are made to the retired employee and surviving spouse.

1969

Pensions increased to $250 a month for life. Previous retirees' pensions also increased ot $250 a month.

1971

Pensions increased to $400 a month for retirement at age 60, $350 at age 59, and $300 at age 58; $250 at age 57 was unchanged. Disability retirement age requirement elimi-

nated. Pensions vested after the required 20 years of service. Pensions paid for 120 months to eligible survivors of active employees who qualified for retirement.

1973

Pensions increased to $525 a month for retirement at age 60 and $425 at ages 57 through 59. Disability pensions increased to $275 a month. Previous retirees' pensions increased by $25 a month. Reciprocity with other Chicago area funds was adopted.

1977

Pensions increased to $550 a month for retirement at age 65 with the required 20 years of service. If service at age 65 was less than the required 20 years, pension equalled 3 percent of $550 multiplied by number of years of service. Pensions vested after ten years of service.

In deciding on priorities for benefit improvements, the Trustees rely in great part on the express wishes of the membership as voiced in union meetings and through other union communications. In determining the maximum amount of improvements, the Trustees rely on the guidance of their independent actuarial resources in order to give employees the greatest benefit possible without jeopardizing the financial soundness of the Fund.

ACTUARIAL FUNDING METHOD

The method of funding used in the Local 705 Pension Fund calculations is termed the Entry Age Normal Cost Method. The basis of the funding method is to estimate what the annual level costs would have been had the pension plan been in effect in prior years, and the cost for each member calculated on the basis of when he or she was first hired, that is his or her entry age. The annual level cost so estimated is the normal cost of the

program. Hence, the entry age normal cost method. Where benefits are based on service, this cost is usually expressed as a level dollar amount per participant.

At the time a pension plan starts, all of the member will have been working for a participating employer varying amounts of time for which no funds have been set aside to meet pension obligations. For example, during 1955, the first year of the Local 705 Pension Fund's operation, 47 members retired with benefits. Therefore, it is necessary to make arrangements to put aside money to take care of the plan participants for the service they have performed prior to the commencement date of the plan. This amount is termed initial past service liability of the plan at the time it is established.

The initial past service liability (or Unfunded Past Service Cost) is the amount to which the normal cost would have accumulated if the plan had been in effect since the employment date of the longest service participant in the plan. Prior to the funding requirements stipulated in ERISA in order for the plan to remain qualified with the Internal Revenue Service, it was necessary to at least pay interest on the unfunded past service cost in addition to paying the normal cost each year. This total cost is termed the current cost of the plan. ERISA requires the unfunded past service liability to be amortized over either a 15, 20, 30 or a 40-year period depending on the type of pension program and tne date the unfunded liability was established, and the cause of the unfunded liability.

While the ideal goal of a pension plan should be to become fully funded, it must be recognized that, in practice, this goal will probably never be fully achieved. Suppose, for example, the plan calls for liquidating the past service liability in 40 years. It would be unthinkable that within that 40-year period benefits would not be increased and that other provisions of the plan would not become more liberal. This has certainly been the case with respect to the Local 705 Pension Fund.

It is important to realize that each improvement will create an additional unfunded liability for all service performed prior to the date of the change. Nevertheless, a plan may be "actuarially sound" even if it is not fully funded. The plan need only recognize all of the costs and make provisions for meeting these costs over a reasonable period of time in order to be an actuarilly sound program.

As stated previously, the Local 705 Pension Fund has met all requirements of funding adequacy that were applicable from time to time. Further, the current plan provisions and the contributions currently in effect are in compliance with the minimum funding requirements of ERISA.

PROBABILITY OF RECEIVING A BENEFIT

Actuarial probability, like other probabilities derived from statistical studies, is based on the Law of Large Numbers and lacks meaning when applied to individual cases. There are so many peculiar circumstances and chances that order appears only when large numbers are considered. For example an individual member probably has a much better estimate of his own probability of quitting his job than anything the actuary might tell him. Just as a person purchasing a five year term insurance policy is not informed of his or her probability of dying so that payment will be made, the pension plan member is not informed of his or her probability or receiving pension. We know of no plan which has attempted to provide this type of information.

OBJECTIVE OF A PENSION FUND

The best way to view a pension fund is establish a grasp of its objectives. Retirement plans are undertaken for numerous reasons such as personnel efficiency objectives and tax incentives. However, the basis objective of a pension fund is to pro-

vide for the economic needs of its participants under the major hazards facing them; namely, superannuation, disability and death.

Within this basic objective is the primary purpose of the pension fund—to provide income after a participant has outlived his normal productive period. While there is no precise age at which this occurs, the most common age currently in use in private pension plans is age 65, the age at which unreduced Social Security benefits are first payable.

Many public systems permit retirement with full benefits at age 60 or after a minimum period of 35 years. Union negotiated pension plans have recently been reducing the age requirement for full benefits to age 60 or 62 or after a minimum of 30 years of service.

In the case of the Local 705 Pension Fund, the program is designed to provide an incentive for career employees age 57 or older to terminate and receive substantial monthly income to permit replacement by younger employees. There is no mandatory retirement. However, the capital value of a truck and cargo is significant and both the employers and the union desire a workforce which:

- is experienced (through limited turnover) so that driver capability is dependable, and
- has reduced potential of physical incapacity related to eyesight, back problems, potential heart problems, and other such factors with higher incidents at older ages.

Thus, the pension program is an integral part of industry performance.

Many programs in other industries have also been designed to meet industry needs. Significant changes in acceptable design will have ramifications beyond the pension plan cost. National pension programs, such as Social Security, do not identify to these types of goals.

Therefore, the Private Pension Plan approach has been to provide benefits at predetermined retirement ages for career employees so that they could afford to retire. The fundamental economic purpose was to provide a method of "insuring" that those who were still working beyond what was generally perceived to be the average productive age could retire and be replaced by younger, more productive individuals.

"BENEFITS ARE WAGES" CONCEPT

A strict interpretation of the concept of benefit plan contributions as part of wages, and therefore allocable and possibly refundable, would destroy the insurance concept whether the plan provided for life insurance, medical expenses, or life annuities. The concept is that for a relatively small contribution (premium) from a large number of participants, large amounts can be paid in the events of untimely death, severe illness, or living too long. What the individual receives in return for employer contributions is money—generally in the form of a life annuity—when and if certain events occur. The amounts paid to a retiree or beneficiary are generally far larger than the aggregate of contributions related to his or her work period. If contributions were considered to be allocated on an individual basis and regarded as sacrosanct then the scheme would collapse.

ACTUARIAL CALCULATION RESULTS

Introduction

The purpose of the actuarial calculations developed for this affidavit is to quantify liabilities if it were to be determined that past and present covered employees have a right of recovery based on the premise discussed in the Purpose section.

As discussed earlier, there are two possible bases of recovery. In the case of a multi-employer fund, such as the Local 705

Pension Fund, the probable basis of recovery was considered to be a payout to the employee of employer contributions made in accordance with collective bargaining agreements related to work performed by those individuals who might have a right of recovery. This would probably be increased to give effect to a reasonable rate of interest on such contributions for prior periods. We have also considered an alternative basis of recovery which was considered to be a vested accrued benefit, in accordance with the plan provisions related to periods of employment for those individuals who might have a right of recovery.

Employee data available for multi-employer plans, which very often have large numbers of employers (many of whom are small and have limited bookkeeping and personnel capabilities) is generally not as precise as for single-employer plans. Historical data for those employees who are no longer covered by the fund is also limited. Records for the Local 705 Pension Fund are excellent for current, active members, but detailed records for those who terminated in past years are not readily available. Techniques were used to devlop the best actuarial estimates possible using available data. The methods used are fully discussed in the Appendix. The results of our calculations concerning the Local 705 Pension Fund are discussed in the following material.

Local 705 Pension Fund

Actuarial calculations were made separately regarding the potential impact of *Daniel* due to possible cause of action by:

- individuals who terminated plan participation prior to January 31, 1977, without becoming eligible for any benefit, and
- participants who were active on January 31, 1977, and who could claim to be individuals belonging to the class of participants that were defrauded.

With respect to the terminated group, we considered only individuals who terminated within the ten-year period prior to January 31, 1977, since records prior to that time were not reasonably available. Also, no calculations were performed concerning individuals who terminated with deferred vested benefits during this time period. If these individuals were to receive a refund of employer contributions made during their participation, there would be an increase in the liabilities calculated. Accordingly, the results are understated by these exclusions.

Regarding active participants as of January 31, 1977 we assumed each of the participants would be given a choice of one of the following: a payment equal to the accumulated contributions based on the rate in effect during his or her participation (with and without interest) hereinafter referred to as "refunds"; or remain in the pension plan to receive a benefit per the plan formula. We assumed that the decision would be a purely financial one, i.e. the participant would select the refund in cases where the present value of the benefit earned to date was less than the refund amount. This assumption does not take into account any other considerations that may influence the participant's decision.

In addition, we have also calculated the increased contribution requirement if the plan were to provide for 100 percent immediate vesting for every past and present participant.

The approximate number of non-vested terminations during the ten-year period was calculated to be 6,048. These individuals had varying amounts of service, terminated under various benefit formulas and contribution rates and, hence, will have varied amounts of potential refunds. The total amount of potential refund for this group was calculated to be $25,665,749 without including the grant of any interest credit.

If interest is to be credited to this amount, we have calculated, based on passbook interest rates in effect during this period for Chicago Savings and Loan Associations, that the $25,665,749

would be increased to $32,525,864. This latter amount represents 26.45 percent of the pension fund assets on January 31, 1977.

Quite obviously, if all terminations from the inception of the plan were included in this calculation, the results would be much higher. Since we do not have data concerning the first twelve years in a form similar to the data during the last ten years we are not able to conjecture the additional amount of liabilities that would be incurred. Further, as stated previously, vested terminations have not been included in the calculations.

The results of our aggregate calculations concerning the active participants as of January 31, 1977, yields an estimated refund of accumulated contributions to 13,464 participants of approximately $95,522,135 without interest and $116,119,434 with interest.

Therefore, based on the calculations, there is a potential liability (or diversion of fund assets) for those groups of individuals considered in our calculations of $148,645,298. This amount exceeds the value of the Local 705 Pension Fund, which was approximately $122.5 million at book value on January 31, 1977. We are not in a position to determine what portion of this liability could actually be diverted from the Local 705 Pension Fund assets if *Daniel* is upheld. Table 1 illustrates the impact of diverting portions of this potential liability on the Local 705 Pension Fund.

Table 1

Local 705 Pension Fund

EFFECT OF DIVERSION ON FUND ASSETS

	Percent Diversion							
	100%		75%		50%		25%	
	Dollar	%*	Dollar	%	Dollar	%	Dollar	%
Non-Vested Terminated Participants	$ 32,525,864	26.45%	$ 24,394,398	19.84%	$16,262,932	13.22%	$ 8,131,466	6.61%
Active Participants	116,119,434	94.42	87,089,575	70.82	58,059,717	47.21	29,029,858	23.61
Total	$148,645,298	120.87%	$111,483,973	90.66%	$74,322,649	60.43%	$37,161,324	30.22%

*Percent of Local 705 Fund Assets on January 31, 1977.

The percent figures in Table 1 apply only to the percent of the potential liability and not to the percent of any number of individuals in either class specified in the table. For example, a refund of accumulated contributions of $4,019 might represent one non-vested individual who terminated in 1975 and who had five years of participation or it might represent seven individuals who terminated in 1969, each with only one year of participation.

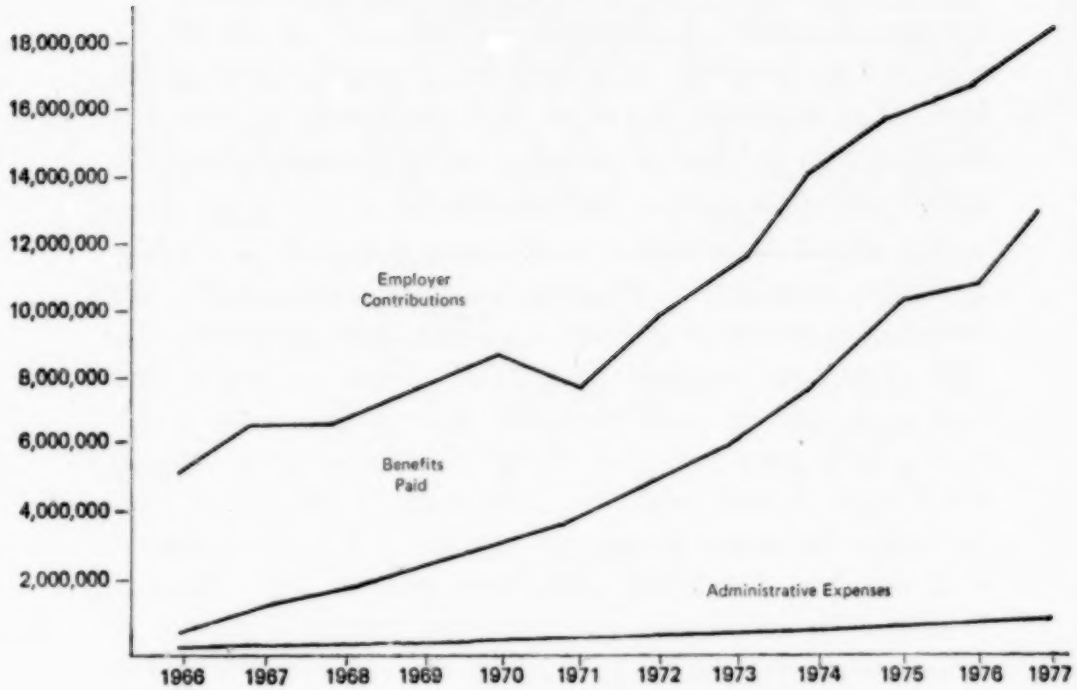
Furthermore, in the situation of 100 percent diversion of the potential liability there would still remain approximately 2,431 active individuals participating in the Local 705 Pension Fund. The present value of the benefits earned to date by these remaining participants would be approximately $90,301,169. In addition, there would remain another liability of $110,236,169 representing the present value of expected benefit payments to the present group of benefit recipients (retirees, surviving spouses, surviving children, disability retirees and terminated vested).

If *Daniel* were upheld and thereby cause a liability of some or all of the portion of the potential liability of $148,645,298, it is possible that the remaining active participants could all request early retirement (since on the average they satisfy the age requirement of 57 and the required service of 20 years). In such an event the plan might seek termination.

However, we will assume the plan will continue in operation and to meet the minimum funding requirements of ERISA. We will also assume that the remaining group of participants will only elect normal retirement upon attainment of age 65. The estimated weekly contribution requirement based on a 50 week workyear (which grants one year of benefit service per the present plan provisions) necessary to meet the minimum funding requirement will vary depending on the amount of potential liability actually diverted from the Local 705 Pension Fund. Table 2 illustrates the increased contribution rates.

CONTRIBUTIONS, EXPENSES, AND BENEFITS

(Years Ending January 31)



Fund Statistics As Of January 31, 1977

As of January 31, 1977, there were 16,003 active participants in the Fund. In addition, there were 3,117 receiving benefits from the Fund—one retiree for every five active Fund members. Thirty-three terminated members had a vested benefit payable beginning at age 65.

Many of the active participants are eligible for benefits immediately or are vested in benefits at age 65 if they terminate employment. The following table summarizes the approximate distribution of the 16,003 active participants as of January 31, 1977:

	Number of Participants	Percentage of Total Group
Eligible for Immediate Monthly Benefits of $550	45	1%
Eligible for Immediate Monthly Benefits of $525	321	2
Eligible for Immediate Monthly Benefits of $425	501	3
Eligible for Immediate Monthly Benefits of Lesser Amounts	176	1
Eligible for Deferred Vested Pension at Age 65	5,647	35
Total Active Employees who have a Non-Forfeitable Right to a Pension Benefits	6,690	42
Remaining Participants	9,313	58
Total	16,003	100%

In considering all retired, terminated vested and active participants, 9,840 have a non-forfeitable right to pension benefits. This amount comprises approximately 51 percent of all covered employees and retirees.

Of the Fund assets of $122.5 million, $110.2 million is necessary to fund the actuarial value of the pensions payable to present retired members. An additional $122.3 million will be required for benefits accrued to date for those who have vested rights but have not yet retired. This will require an additional $110 million from future employer contributions.

The program is funded by methods acceptable under ERISA. However, provisions under ERISA requiring vesting after ten instead of after twenty years of service—the Fund's approach pre-ERISA—has seriously impacted the Fund. Employer contributions have been increased from $24 a week in 1975 to $30 a week as of January 31, 1977—a 25 percent increase—with only nominal improvements in benefit for the career employees due to this burden.

APPENDIX

Description of Methodology and Results

Local 705 Pension Fund

A. Participants who terminated prior to January 31, 1977 and after January 31, 1967.

Methodology

In preparation for calculating the liabilities for those participants who had terminated from the Local 705 Pension Fund prior to January 31, 1977, and who were not eligible to receive retirement, death or disability benefits we conducted an actuarial experience analysis. This analysis was conducted to ascertain the actual rate of separation from participation due to termination of covered employment by those individuals not eligible to receive retirement benefits and who had not attained age 57, the earliest age an individual may be eligible to retire provided he has also earned the applicable 20 years of service.

Based on employee census information we obtained from the Fund office in the course of preparing our actuarial valuations for this plan, we calculated that during the last two full plan years there were 3,399 participants who terminated from covered employment. This calculation was based on participant census information as of January 31, 1975, 1976, and 1977. We compared each census to derive the total of 3,399 unmatched participants from one year to the next which we coded terminated participants. This is an average of 1,699.5 terminations per year.

The results of this short-term experience yielded a rate of termination slightly higher than that derived in our last such analysis conducted in 1972. However, it was decided that the rates of termination derived in our more expansive earlier study would be used for the purposes of our ensuing calculations. To the extent our earlier rates are conservative, i.e. assume less than

actual number of terminations from plan participation, the results will be understated. A summary of the rates of termination by attained age which we used for calculation purposes are illustrated below. This summary illustrates the anticipated number of terminations for a group of 100 plan participants who have attained the age specified.

Age	Rate	Age	Rate	Age	Rate	Age	Rate
20	16.61	32	9.03	44	4.25	56	1.07
21	15.79	33	8.55	45	3.93	57	0.00
22	15.02	34	8.08	46	3.62		
23	14.25	35	7.63	47	3.32		
24	13.52	36	7.20	48	3.03		
25	12.84	37	6.79	49	2.75		
26	12.24	38	6.39	50	2.48		
27	11.66	39	6.00	51	2.22		
28	11.10	40	5.63	52	1.97		
29	10.56	41	5.27	53	1.73		
30	10.02	42	4.92	54	1.50		
31	9.52	43	4.58	55	1.28		

We then applied these rates of termination to age and service distribution exhibits contained in our last seven actuarial valuations. Such distribution are displays of the number of participants as of the census date in certain age and service categories, with age categories running from under age 25 to age 70 and over, and service categories ranging from under one year to 40 and over years. The results of applying the termination rates to those categories of participants not eligible to retire and not eligible for a vested benefit are given on the following page.

Year	Census Date	Vesting Requirement	Active Participants		Number of Expected Terminations
			Total Number	Non-Vested Under Age 57	
1977	1/31/77	10 years	15,895	8,768	746
1976	1/31/76	10 years	16,650	9,543	808
1975	1/31/75	20 years	15,732	12,019	892
1973	8/01/73	20 years	15,011	11,534	854
1971	1/01/71	20 years	16,372	12,880	996
1969	1/01/69	20 years	14,979	13,102	913
1967	1/01/67	20 years	14,078	12,284	839

Therefore, we have calculated the number of non-vested terminations in seven of the last ten years based on the expected rates of such terminations. Based on the above results an overall rate of 5.56 percent of the total participant number is the average expected number of non-vested terminations in a given year during the last ten years.

It should also be noted that during this period there were individuals who terminated with deferred vested benefits. Such individuals were not considered in our calculations. Although there is a liability carried for such individuals in the actuarial valuation, if there would be a refund of accumulated contributions made during their participation this would represent an increase over the present liability since the value of contributions exceeds the value of the vested benefit.

Results of Calculations

Having completed this first step, we next calculated an estimate of i) the present value (i.e. lump sum as of January 31, 1977) of the benefits such individuals would be entitled to if they became fully vested in the accrued benefits in effect at the time of their termination and ii) the accumulated contributions based on the rates contained in the collective bargaining agreements in force during the employment of such terminated individuals.

Since the information during the last ten years was calculated on actual participant data which was provided in a discontinuous fashion, we interpolated the results for the intervening years when no census was taken. The results of this calculation are given below:

Year of Termination	For Non-Vested Participants Who Terminated During the Years: Present Value of Accrued Benefits	Accumulated Contributions Without Interest
1977	$ 801,300	$ 3,446,013
1976	900,100	3,401,084
1975	1,795,800	3,775,118
1974	1,813,300	3,123,910
1973	1,826,300	2,472,702
1972	1,489,200	2,279,866
1971	1,593,600	2,087,030
1970	1,358,800	1,884,168
1969	1,440,300	1,681,305
1968	1,338,000	1,504,553
Total	$14,356,700	$25,655,749

Therefore, if the Local 705 Pension Fund were to grant each non-vested terminated participant a benefit based on service earned up to the point of termination and the benefit in effect at the time of termination, with the accrued benefit being 3 percent of the maximum benefit for each year of service earned (an accrual rate allowed under ERISA), an additional liability of $14,356,700 would be established This liability represents 11.7 percent of the pension fund assets as of January 31, 1977.

If the Local 705 Pension Fund were to grant each terminated participant (during the time period under study) an amount equal to the accumulated contributions called for in the collective bargaining agreements in effect during each individual's years of actual participation, this would equal $25,655,749, not including the grant of any interest credit,

for only those individuals who had terminated during the ten-year period ending January 31, 1977.

If interest is to be credited to this latter amount we have calculated, based on pass book interest rates in effect during this period (average 5 percent) in Chicago area Savings and Loan Associations that the $25,655,749 would be increased to $32,525,864. This latter amount represents 26.45 percent of the pension fund assets on January 31, 1977.

Quite obviously, if all terminations from the inception of the plan were included in this calculation the results would be much higher. Since we do not have data information concerning the first twelve years in a fashion similar to the last ten, we are not able to conjecture as to the additional amount of liabilities that would be incurred. Further, as stated previously, vested terminations have also not been included in the calculations. Therefore, we shall restrict our discussion of the impact on the pension fund of either alternative calculated to the liability for non-vested terminations during the last ten years.

B. Active Participants January 31, 1977 Methodology

It is our understanding that if *Daniel* is upheld, the present active participants could claim to be individuals belonging to the class of participants that were defrauded. In order to estimate the type and amount of liabilities this interpretation would cause the fund to experience we assumed the following: Each of the present plan participants would be given a choice of a payment equal to the refund of accumulated contributions based on the rate in effect during his or her participation (with and without interest, hereinafter referred to as "refund") or remain in the pension plan to receive the benefit per the plan formula. We assumed that the decision would be a purely financial one, i.e. the participant would select the refund in cases where the present value of the benefit earned to date was less than the refund amount.

This calculation was based on the age and service distribution contained in our last actuarial report for the plan year ending January 31, 1978, and the contribution rates in effect since 1955. The following table illustrates the maximum pension contributions that could have been received during each year based on a 52 week workyear for an individual covered under a Local 705 collective bargaining agreement:

Year	Amount	Year	Amount	Year	Amount
1955	$104.00	1963	$311.70	1971	$ 676.60
1956	104.00	1964	363.60	1972	795.00
1957	104.00	1965	415.20	1973	910.00
1958	129.80	1966	476.00	1974	1,053.00
1959	130.00	1967	477.00	1975	1,215.50
1960	158.60	1968	507.00	1976	1,365.00
1961	234.00	1969	558.80	1977	1,521.00
1962	234.00	1970	585.00		

The maximum amount accumulated contributions, without interest, for an active participant is therefore $12,428.20. Assuming an average interest rate during the 22-year period of 4 percent per annum this maximum would be increased to $16,248.73.

Results

Based on our calculations derived from the age and service distribution on January 31, 1977, we found that there would be approximately 13,464 participants who would have accumulated contributions (without interest) representing a larger amount than the present value of their accrued benefit. For example, under the present plan provisions an individual age 47½ with 12½ years of service would have an accrued monthly benefit of $206.25 first payable at age 65. The present value of this benefit, discounting for interest at the actuarial rate of 6 percent per annum and mortality, would be $6,990.39. The accumulated contributions, if allocated, for

this individual would be approximately $10,347 without interest credit or approximately $12,355 with an interest credit of 4 percent per annum. It is our assumption the individual would elect to receive the accumulated contributions.

The results of this aggregate calculation yields an estimated refund of accumulated contributions to 13,464 participants of approximately $95,522,135 without interest and $116,119,434 with interest. In addition there would remain a liability for benefits earned to date for the remaining 2,431 active participants of approximately $90,301,508. It should be noted that the average age of the group remaining would be 57.5 years and the average length of service would be in excess of 20. This means that, on the average, each of the remaining 2,431 participants would be eligible to receive, under the provisions of the present plan, an immediate life annuity of $425 a month. If this were the case, the present value of the benefits related to the remaining participants would be determined by multiplying $425 a month by 12 months further multiplied by 2,431 and by the annuity factor 11.2472 (6 percent interest and mortality) yielding a lump sum of $139,443,910. This amount is in excess of the earlier amount which was calculated and which will be used in our further discussion. Therefore, the total liabilities of the current *active* group would now read as follows:

1. Benefit Recipients	$110,236,169
2. Participants Electing to Remain Under Plan	90,301,508
3. Participants Electing Refunds (no interest credit)	95,523,135
Total	$296,060,812

Therefore, the active life liability on January 31, 1977, would be increased 20.05 percent from $246,606,161 to $296,060,812 assuming no interest is credited to refunds. This increase is equal to 40 percent of the fund assets on January

31, 1978. If interest is credited to refunds then an additional $20,597,299 of liability would be incurred bringing the increase to 56.7 percent of the fund assets on January 31, 1978.

/s/ RICHARD I. CITRON
(Signature)

Subscribed and sworn to before me on this 4th day of May, 1978.

/s/ DIANE M. COBURN
[SEAL] *Notary Public, Diane Coburn*

My Commission Expires March 29, 1980.